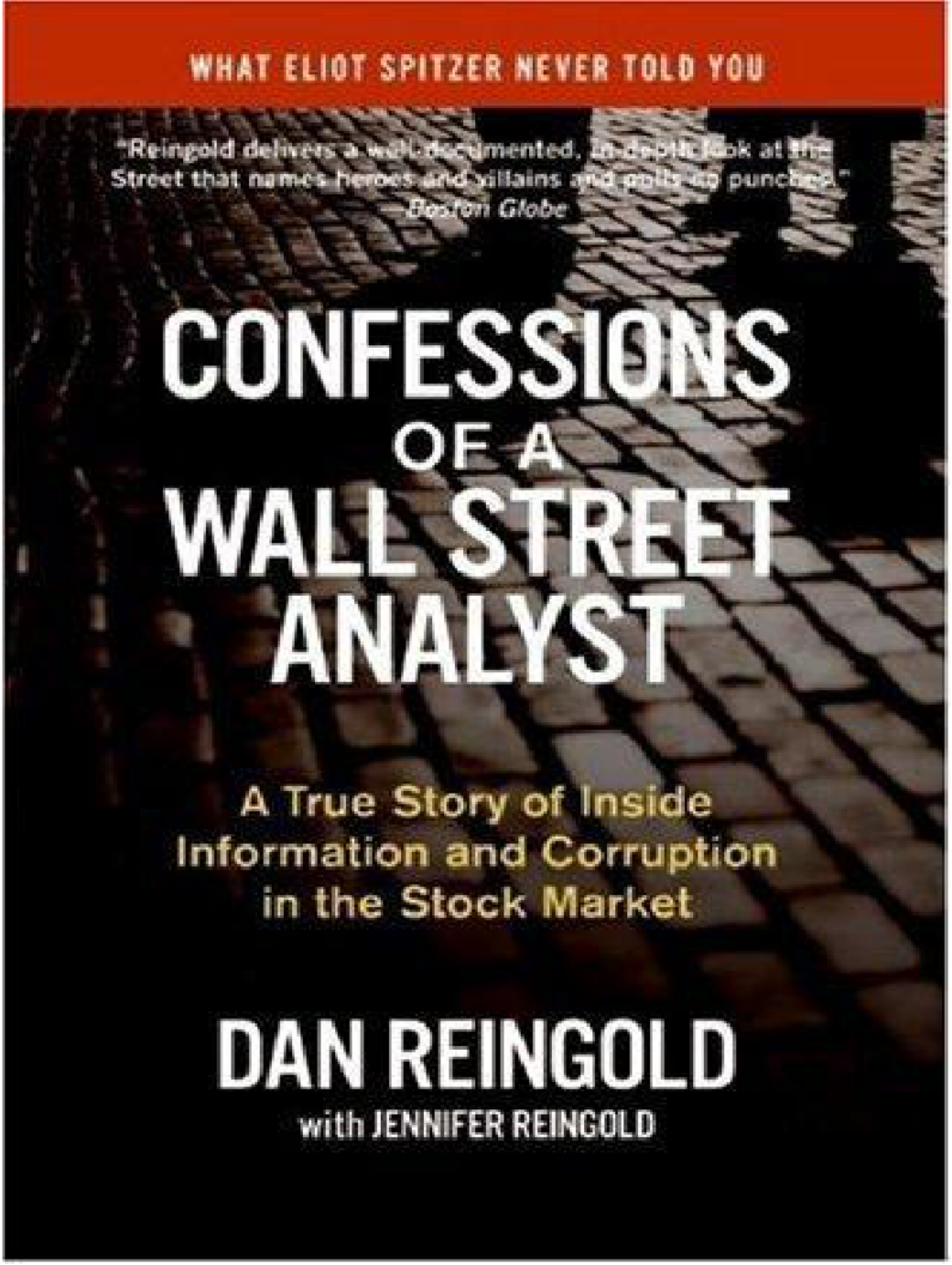
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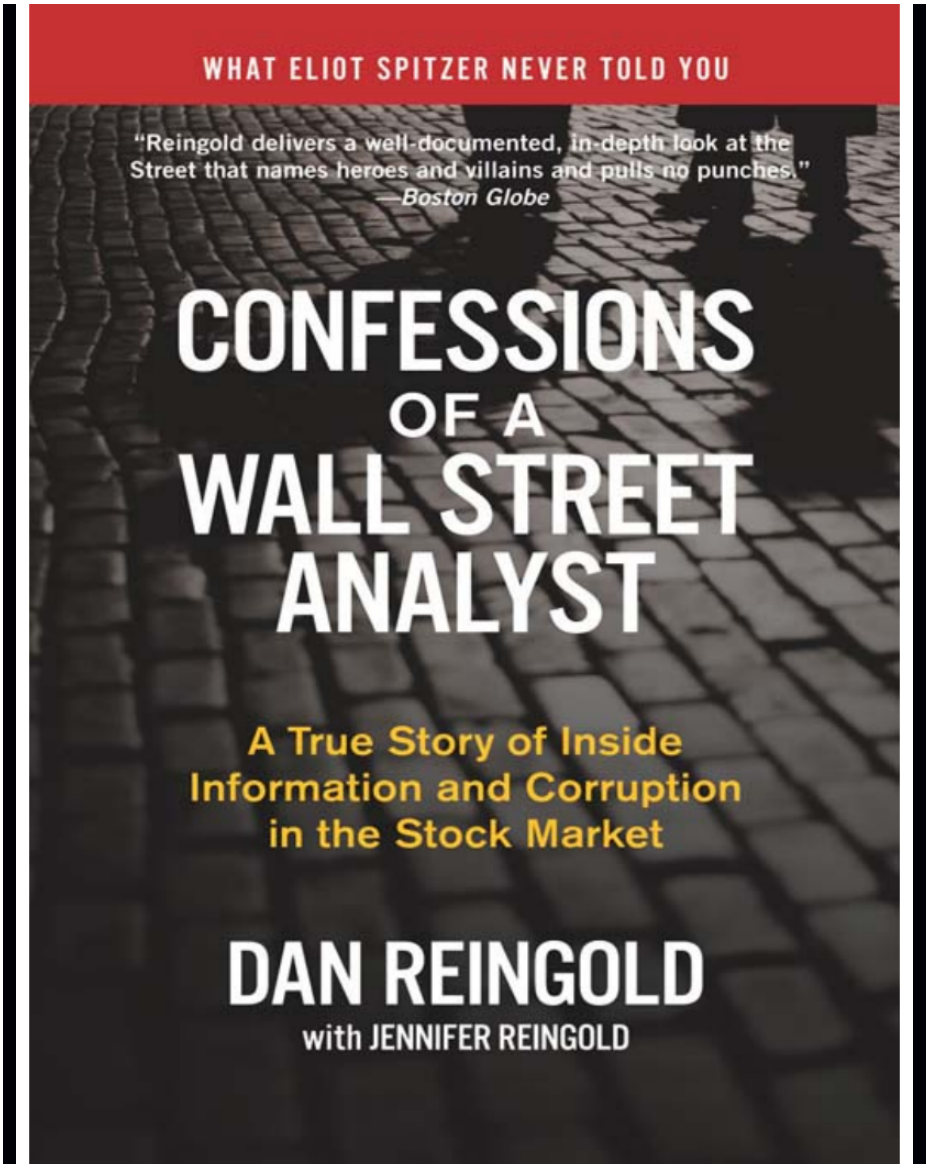
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Confessions of a Wall Street Analyst

A True Story of Inside Information and Corruption in the Stock Market

DAN REINGOLD

***with* JENNIFER REINGOLD**

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To *Dad, for teaching me the importance of integrity and hard work.*

To *Mom, for teaching me to stand up for what I believe.*

To *Paula, my love and best friend.*

To *Jessica and Lisa, who fill my heart, for being so fervently independent and, like your mom, so graceful, humble, and smart.*

The *author's proceeds from this book are being donated to charity.*

The events depicted in this book reflect my experiences on Wall Street and at MCI Communications Corporation. The conversations recounted here are based on my recollections and, wherever possible, the recollections of others present at the time, audio and video tapes of company presentations and conference calls, my e-mail records, and my contemporaneous notes. When describing events or conversations that occurred when I was not present, I have relied on a variety of sources: the accounts of people who were there, transcripts or recordings of conference calls and meetings, press releases, newspaper reports, speeches, court testimony, and other documents. Citations have been noted extensively in the text and the endnotes.

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Acknowledgments

MANY PEOPLE NEED TO BE THANKED for helping Jennifer and me with this book and also for helping me during my career. Inevitably, some must remain anonymous because they served as confidential sources for some of the material presented in this book. You know who you are. Thank you.

Others, however, can and should be thanked loudly. Ed Greenberg convinced me to leave MCI for Wall Street. Without his persistence—and confidence in me—I doubt I would have made the move. Most important, Ed taught me that a Wall Street analyst can and should operate with integrity, independent from the myriad conflicts of interest inherent in the brokerage and investment banking businesses. I still stand in awe of the example he set. Thank you, Ed.

I also thank the talented and dedicated members of my research teams at Morgan Stanley, Merrill Lynch, and Credit Suisse First Boston. Each helped this book in some immeasurable way. Their memories helped to flesh out and corroborate mine. Just as they did when we worked together, they identified passages in need of more explanation and those that needed to be cut down or omitted. In particular, I thank Megan Kulick, Mark Kastan, Ehud Gelblum, and Ido Cohen for critiquing draft chapters and for adding details that I had forgotten. I also thank Connie Marotta, my loyal executive assistant for ten years, for keeping me organized and on schedule through most of my Wall Street career and for her uncanny ability to anticipate and thereby avoid disasters in the making. Several other members of my research team deserve mention as well: Marty Dropkin, especially for his insights on policy matters; John Sini, for his often-appropriate cynical view of Wall Street's devious ways; Julia Belladonna, for her calm wit, brains, and stamina; and John Doughty, Michael Winston, and Michael Shrekgast, for their good humor and hard work, especially during the depressing years of 2000–2002, when the bubble was deflating and the analyst profession was being vilified in the

press.

Patricia Coronado, a former buy-side client now running a hedge fund, convinced me that it was imperative that the Wall Street she and I had experienced in the nineties be documented and that I should be the one to do it. David Pesikoff, former buy-side client and now a friend, read the manuscript thoroughly and provided numerous insightful suggestions. My friend and neighbor, Eric Hemel, a former Wall Street research director and number one–rated analyst, offered comments that cut to the core of my thesis and, in so doing, forced me to rethink several points made in the prologue and several policy suggestions in the afterword. Matt Bowman, also a friend and neighbor, read several chapters and offered several key corrections.

Jim Hayter, my former boss at MCI, read several chapters and provided highly detailed memories of our time in the MCI investor relations department. Jim also shared his impressive photo collection and several key documents from his files. Jeff Jacobs, my friend and Merrill Lynch stockbroker, clarified and sparked many memories.

In the course of this project, I have also consulted numerous attorneys. David Fein of Wiggin and Dana; David Korzenik and Jeff Miller of Miller, Korzenik, Sommers; and Mark Reingold, my brother, read and commented on the manuscript. Their suggestions have proven extremely helpful and insightful, on both legal and nonlegal issues. My brother Mark deserves a special appreciation for serving as a trusted advisor and valuable sounding board throughout the book-writing process.

The last reader to mention is Bob Atkinson. Bob is a veteran of the telecom wars, an attorney who was general counsel at Teleport and is now director of policy research at the Columbia Institute for Tele-Information (CITI) at the Columbia Graduate School of Business. I thank Bob and CITI's longtime director and professor of finance and economics at Columbia, Eli Noam, for convincing me to join the Institute when I left CSFB in 2003. This book, especially the policy recommendations in the Afterword, benefited immensely from the lively discussions we have had at various CITI conferences on corporate governance and telecom recovery. Bob read the entire book in two days, just as we were about to submit the final manuscript. He raised several very important questions and issues that led to important clarifications.

Special thanks also go to the great crew at HarperCollins. Leah Nathans Spiro and Marion Maneker championed our project from the

minute Jennifer called Leah, her old *Business Week* colleague. Their enthusiasm has been inspirational at critical moments in the process. Leah did a marvelous job of helping us see the forest for the trees. She masterfully sculpted away portions of chapters that were too long or lacked a connection to our larger themes. Leah is an uncompromising perfectionist, and there is no doubt that this book, and Jennifer and I, have been the beneficiaries of Leah's truly exceptional talents and drive. Thank you, Leah. Also at HarperCollins, much appreciation goes to our lawyer, Kyran Cassidy; Libby Jordan, Collins associate publisher; our cover designer, Georgia Morrissey; D. S. Aronson, copy chief; our copyeditor, Cecilia Hunt; and Alexandra Kaufman, the summer intern who so adroitly helped shepherd the manuscript and especially its photos through production.

Also deserving of thanks are Michael Martinez, our outstanding factchecker, who endured this project and its time pressures with enthusiasm, and my agent, Anne Sibbald, of Janklow & Nesbit, who instantly got what this book was about and encouraged us throughout.

Without Jennifer Reingold, my writer and my niece, this project would never have been started, let alone completed. When it came time for me to contemplate writing a book about my time on Wall Street, she was the obvious collaborator. Jennifer and I had discussed the analyst-conflict issue for years, and we greatly respected each other's knowledge and perspective. And Jennifer had just finished writing *Final Accounting,* so she was experienced in exactly the kind of project I envisioned: a first-person, nonfiction narrative in the context of business fraud and scandal. Jennifer navigated through agent picking, proposal writing, and proposal pitching. And then, she magically converted my 600 pages of typewritten stream-of-consciousness memories into a readable manuscript. Jennifer probed me relentlessly, and her tenacity and investigative rigor yielded a narrative that is far more personal, revealing, and, I hope, useful than I ever imagined possible. Jennifer forced me to learn things about Wall Street, about investing, about human temptation, and about myself that I didn't know when we started this project. Jennifer's husband, Randall Lane, and their daughter, Sabrina, deserve special thanks; Randall for patiently tolerating Jennifer's late nights at the computer and for his incisive comments on the manuscript, and Sabrina for sharing her mom's time with this book project.

Finally, I want to thank the most important people in my life: my wife, Paula, my two daughters, Jessica and Lisa, and my parents, Jack and Muriel. Each read numerous drafts of the manuscript and offered important reactions and suggestions. More important, however, each

inspired me to continue slogging through the painful process of producing a book, especially a book about one's own actions and mistakes. Jessica and Lisa, I hope that my example, even my failures, are as instructive to you as your Grandma's and Grandpa's examples have been to me.

ACKNOWLEDGMENTS FROM JENNIFER REINGOLD

To Dan Reingold, for his integrity, tenacity, incredible work ethic, and guts.

To Mark Reingold, for his sharp mind and passion for the subject.

To Mom, Guy, Sue, and Rodney, for keeping me sane.

To Leah Nathans Spiro, for getting it, for caring, and for pushing us to the end.

To Michael Martinez, for backing us up with calm and grace.

To John Byrne, for always understanding.

To my husband, Randall Lane, for holding my hand and shooing away the clouds.

And to my beautiful daughter, Sabrina, simply for being.

Cast of Characters

MCI (1983–1989)

Bill McGowan, Founder and CEO

Orville Wright, President, COO, and Vice Chairman

Bert Roberts, President, CEO, and Chairman (later Chairman of MCI WorldCom)

William Conway, Jr., Chief Financial Officer

Daniel Akerson, Chief Financial Officer, later President

Doug Maine, Chief Financial Officer

Jim Hayter, Vice President of Investor Relations

Connie Weaver, Director of Investor Relations

MORGAN STANLEY (1989–1993)

Research Department

Ed Greenberg, senior telecom analyst

Rick Klugman, my associate

Mary Meeker, software analyst and later, Internet analyst

Mayree Clark, head of global equity research

Jack Curley, head of global equity research

Jay Cushman, head of domestic equity research

Peter Dale, head of domestic equity research

Executives and Investment Bankers

Robert Greenhill, President until March 1993

John Mack, President, March 1993–March 2001

Bob Murray, telecom banker

Joe Perella, head of investment banking

Frank Quattrone, head of technology banking

Clay Rohrbach III, investment banker

Paul Taubman, telecom and media mergers and acquisitions banker

Jeff Williams, head telecom banker

MERRILL LYNCH (1993–1999)

Research Department (Management)

Ray Abbott, attorney for research compliance department

Rosemary Berkery, co-director of global research, then General Counsel

Jack Lavery, head of global equity research

Andy Melnick, co-director of global research

My Research Team

Julia Belladonna

Ehud Gelblum

Mark Kastan

Rick Klugman

Megan Kulick

Connie Marotta, my executive assistant

Dick Toole

Research Colleagues

Neil Barton, telecom analyst in London, covering BT and European telecom stocks

Henry Blodget, Internet analyst

Chris McFadden, replaced Barton in 1995, covering European telecom stocks

Jessica Reif-Cohen, cable, media, and entertainment analyst

Executives

Dan Tully, CEO and Chairman

David Komansky, President and CEO

Herb Allison, head of investment banking and later President

Jerry Kenney, Executive Vice President, strategy and research

Tom Davis, head of investment banking

Investment Bankers

Matt Bowman, Executive Vice President of investment banking, internal banker to Merrill Lynch, banker to MCI and other major companies

Michael Costa, telecom mergers and acquisitions specialist

Tom Middleton, co-head of telecom investment banking

Rob Kramer, telecom banker

Frank Maturo, banker to Level 3

Mark Maybell, head of telecom and media banking

Mark Vander Ploeg, banker to the Anschutz Corporation

Sean Wallace, telecom banker

CREDIT SUISSE FIRST BOSTON (1999–2003)

Research Department (Management)

Al Jackson, global research director

My Research Team

Julia Belladonna

I do Cohen

Ehud Gelblum

Mark Kastan

Connie Marotta

Research Colleagues

Cindy Motz, U.S. wireless telecom analyst

Executives

John Mack, CEO, beginning in August 2001, replacing Allen Wheat

Allen Wheat, CEO through August 2001

Chuck Ward, head of investment banking, later President

Brady Dougan, head of equities, now CEO of CSFB

Frank Quattrone, head of technology investment banking

COMPETITOR TELECOM ANALYSTS

Blake Bath, Lehman Brothers

Stephanie Comfort, Salomon Brothers and Morgan Stanley

Frank Governali, CSFB and Goldman Sachs

Joel Gross, Donaldson, Lufkin & Jenrette (DLJ)

Jack Grubman, PaineWebber, Salomon Brothers, and Salomon Smith Barney (Citigroup)

Rick Klugman, PaineWebber, Goldman Sachs, and DLJ Robert Morris, Goldman Sachs

Adam Quinton, Merrill Lynch

Tim Weller, Donaldson, Lufkin & Jenrette

"BUY-SIDE" CLIENTS (MUTUAL FUNDS, PENSION FUNDS, HEDGE FUNDS, ETC.)

Abby Johnson, Fidelity Management & Research (telecom analyst, now President of Fidelity)

Rob Gensler, T. Rowe Price

Bill Newbury, TIAA-CREF

Peter Lynch, Fidelity Management & Research

Nick Thakore, Fidelity Management & Research

OTHER WALL STREET EXECUTIVES

Sandy Weill, Chairman and CEO of Citigroup

Jon Corzine, co-CEO of Goldman Sachs, now U.S. Senator from New Jersey

TELECOM EXECUTIVES

AT&T

Bob Allen, Chairman and CEO, from 1988 to November 1997

John Walter, President, from December 1996 to July 1997

C. Michael Armstrong, Chairman and CEO, from November 1997 to November 2002

Dan Somers, CFO, 1997–1999

John Zeglis, General Counsel and later CEO of AT&T Wireless

Chuck Noski, CFO, 2000–2003

British Telecom (BT)

Iain Vallance, Chairman

Sir Peter Bonfield, CEO

Robert Brace, CFO

Global Crossing

Gary Winnick, founder, Chairman

Bob Annunziata, CEO (former CEO of Teleport and President of AT&T's business services unit)

Leo Hindery, CEO (former President and CEO of Telecommunications, Inc. and of AT&T's broadband and Internet division)

Tom Casey, CEO

David Walsh, President

IDB

Jeffrey Sudikoff, CEO

Ed Cheramy, President

Rudy Wann, CFO

Qwest (including its founding shareholder, The Anschutz Corporation)

Phil Anschutz, Chairman of Qwest and the Anschutz Corporation

Cy Harvey, President of the Anschutz Corporation

Joe Nacchio, CEO of Qwest, former AT&T executive

Robin Szeliga, CFO of Qwest

Robert Woodruff, CFO of Qwest

Lee Wolfe, Vice President, Investor Relations

WorldCom (originally LDDS)

Bernie Ebbers, Chairman and CEO

Charles Cannada, CFO

Scott Sullivan, Treasurer, then CFO

John Sidgmore, Vice Chairman, founder of UUNet

Blair Bingham, investor relations manager

OTHER TELECOM EXECUTIVES

Jim Crowe, CEO of MFS, later CEO of Level 3 Communications

Bill Esrey, CEO and Chairman of Sprint

Chris Gent, CEO of Vodafone

Sam Ginn, CEO and Chairman of AirTouch Communications

Chuck Lee, CEO and Chairman of GTE

Dick Notebaert, CEO and Chairman of Ameritech, later CEO of Qwest

Fred Salerno, CFO of Bell Atlantic, subsequently Verizon

Ivan Seidenberg, CEO and Chairman of Bell Atlantic, subsequently Verizon

Oren Schaffer, CFO of Ameritech, later CFO of Qwest

Sol Trujillo, CEO and Chairman of US West

Ed Whitacre, CEO and Chairman of SBC Communications

MEDIA

Maria Bartiromo, CNBC reporter

Rebecca Blumenstein, *Wall Street Journal* reporter covering telecom companies

David Faber, CNBC reporter and anchor

Charles Gasparino, *Wall Street Journal* reporter covering Wall Street firms, now at *Newsweek*

Gil Kaplan, founder of *Institutional Investor* magazine

Prologue

TUESDAY, MARCH 15, 2005

IT WAS JUDGMENT DAY for Bernie Ebbers, but no one knew it yet.

As I walked into Courtroom 318 of the federal courthouse in Manhattan and took my usual seat in the gallery, it looked like just another long day of waiting. It was the eighth week of Bernie's criminal trial and the eighth day of the jury's deliberations. The stakes were huge: if convicted of all nine counts of conspiracy, securities fraud, and filing false financial statements, the 63-year-old former CEO of WorldCom would likely live out his final days, not on a yacht or on his vast ranch in Canada, but in a federal prison cell.

I stared at Bernie as he sat at the defendant's table, flanked protectively by his high-priced lawyers. Behind him sat his wife of six years, Kristie, and her 20-year-old daughter, Carly. Two of Bernie's own daughters, Joy and Faith, had sat through much of the vigil but had flown home the night before.

The events of the previous few years had been rough for the one-time billionaire. A slight slump had replaced his once-jaunty swagger; his hair and beard had gotten decidedly grayer; his paunch sagged. But oddly, Bernie didn't seem preoccupied by the fact that at that moment twelve random individuals were determining his fate. Seemingly absorbed in a novel, his lined face was totally expressionless. It was strange: I had known the man since 1993 and had clashed with him regularly for years, but after all this time, I still found him inscrutable.

The trial was the final act in a remarkable rags-to-riches-to-rags saga. Bernie Ebbers, a one-time milkman and high school basketball

coach in rural Mississippi, had taken a tiny long distance company and built it into MCI WorldCom Inc., the second largest telecommunications company in the world behind AT&T. He had become a billionaire, a celebrity, the CEO atop the mountain, at a time when his industry and mine—telecom—was one of the sexiest in the world.

But by mid-2002, his company had collapsed in a web of lies and deception. Over $180 billion in shareholder value had evaporated. Over 30,000 WorldCom employees and nearly 200,000 others at related companies had lost their jobs in the telecom bust that followed. And Bernie had gone from a hero to a villain, his reputation as a master of the deal replaced by that of the man who presided over the biggest fraud in history.

Although Bernie and I had never much liked each other, we'd struck up an odd camaraderie in the courtroom, where we'd make small talk or discuss the most recent testimony. Early on in the trial, I ran into Bernie in the men's room, of all places. "How are you holding up, Bernie?" I asked.

"Fine, Dan," he said, turning and looking me in the eye.

"Dan, I know one thing," he said, his face stoic, his voice even. "I just have to stand in front of my God, whenever that comes. I know I didn't do anything wrong."

We both walked over to the sink to wash our hands.

"Bernie, based on what I've heard in the opening arguments," I said, "I don't see evidence that you knew what Scott was doing." I was referring to Scott Sullivan, WorldCom's former CFO, who had already pleaded guilty to numerous criminal charges related to WorldCom's multibillion-dollar accounting fraud.

I was baiting him, of course, hoping he'd tell me something, anything about what had happened. I was as anxious to know the truth as anyone. The news of WorldCom's massive accounting fraud had shocked me to the core. How could I have missed it?

My job as a research analyst on Wall Street had been to understand the numbers. Though I certainly hadn't believed everything Bernie had said over the years, I'd never had reason to question the authenticity of the financial information the company reported. Nor, unfortunately, had the other Wall Street analysts, the bankers, the lawyers, or even the auditors. Bernie's company had been

faking its numbers to the tune of billions of dollars, and none of us had figured it out.

"Dan," Bernie said, "perhaps I *should have* known, but I didn't. It's just a shame, a damn shame. This whole thing is so sad."

He was definitely right on both counts. He should have known. And it sure was sad. Of all the sad things that I had witnessed as the telecom bubble burst, the collapse of WorldCom was most decidedly the saddest, with so many people's livelihoods destroyed by this evil numbers game. I felt infuriated as I listened to him shirk off any responsibility for this horrible situation; no matter what the jury decided, all of this had happened on Bernie's watch and Bernie's watch alone. Although the evidence seemed circumstantial and uncorroborated, at the same time it seemed incomprehensible to me that he hadn't known something about the massive deception.

You see, WorldCom was part of my legacy too. I was driven by both anger and an intense curiosity to understand what had really happened. I had been the lead telecommunications analyst for several of the world's largest and most powerful Wall Street investment banks. It had been my job to analyze the investment prospects of WorldCom and other telecom companies and recommend whether clients should buy, sell, or hold their shares. I took those responsibilities very seriously.

For many years, my research reports and recommendations influenced the way in which billions of dollars were invested in the stock market. My views were printed in leading newspapers and broadcast on CNBC and on teleconferences that were beamed to thousands of retail brokers, savvy professional money managers, and the adoring press. I had been at the top of my field, trading the top rankings with my archrival, Salomon Smith Barney's Jack Grubman, a man who had a radically different view of the role of the analyst from mine. But that didn't help either of us when it came to WorldCom's fraud. Jack had been the leading cheerleader for WorldCom's stock for nearly a decade, and I, too, had recommended its stock for three years, from late 1997 until mid-2000, when the company began to show signs of trouble.

Now those days were long gone. The only people whose opinions mattered were the twelve New Yorkers deliberating in the jury room, strangers who, before the trial, knew little or nothing about WorldCom, the telecommunications industry, Wall Street, or Bernie Ebbers. They had often looked bored and confused, probably

wondering how they'd had the bad luck to get roped into this accounting mess instead of getting to weigh in on glamorous rapper Lil' Kim's perjury trial, which was going on at the same time in the same courthouse, one floor below.

One day I was eating lunch in the building's cafeteria when I looked up to see Bernie and his family setting their trays down near Lil' Kim and her entourage, each clueless as to the other's existence. Finally, Bernie's stepdaughter, Carly, realized who Lil' Kim was and struck up a conversation. It was both hilarious and sad to realize how much the rap star and the business star, inhabitants of such disparate worlds, suddenly had in common.

At about 12:20 PM on March 15, I was chatting with Bernie's wife and her daughter outside the courtroom when a reporter suddenly darted out and told us that the stenographer had just come in. That, I had learned, was a sure sign that something was about to happen. Perhaps it was as harmless as a note from the jury requesting documents or asking for Domino's Pizza for lunch instead of that lousy cafeteria food. That one had gotten some laughs a few days back.

But today, the jury had discussed more weighty matters than the merits of pepperoni versus mushrooms. We all hustled back into the courtroom and took our seats. A few minutes later, the court clerk strode purposefully out of the chambers.

"We have a verdict," he announced.

A frisson of energy rippled through the room.

They had a verdict.

IN APRIL 2003, I quit Wall Street after 14 years as an analyst and more than two decades in the telecom industry. I'd experienced one of the most dramatic rides in financial history, having had the good fortune of arriving on Wall Street at the beginning of a historic bull market and the misfortune of leaving when it was in ruins. I'd witnessed—and been a part of—the transformation of telecom from a sclerotic, regulated backwater to a glamorous whirlwind of massive M&A deals and Internet-crazed public stock offerings. I'd experienced firsthand the transformation of the stock analyst from a backroom number cruncher to a rainmaker whose recommendations were followed breathlessly and who often determined whether an investment bank

won or lost multibillion-dollar deals. I'd lived the lush life, traveling on private planes around the globe, eating in the finest restaurants, and sitting in front row seats at World Series games, US Open tennis championships, and Madonna concerts. I'd even been an unwitting catalyst for a series of sexually explicit e-mails that would rock Wall Street, bringing Jack Grubman to his knees and contributing to the unplanned retirement of his boss, Citigroup CEO Sandy Weill.

But the flip side was a world where work never stopped, where I was literally on call at any time and any place. I was part of an industry and profession that was swallowed up in a devastating mix of fraud, unethical behavior, overoptimism, and financial mismanagement. The bursting of the telecom bubble cost investors far more money and jobs than the dot-com crash and most other market meltdowns in history. And WorldCom was only one ignominious part of this story.

By the time I left my last Wall Street firm, Credit Suisse First Boston (CSFB), I was burned out by the headlong pace and depressed by the beating my profession had taken. But I had also benefited immensely. I walked away with far more money than I had ever yearned for or deserved. In the two years since retiring from the Street, I did some teaching, took a few classes, and spent lots of quality time with my wife, Paula, and our two daughters—things I had far too little time for when I worked on the Street. But I remained intensely frustrated by all the wrongs that had still not been righted. The way the telecom bubble and the rash of conflicted behavior by Wall Street analysts had been portrayed was simplistic and often wrong. The investigators had focused on some types of wrongdoing—fraud at WorldCom and dishonest research on the Street—but had ignored other equally egregious practices, such as the leaking of inside information, which were at the core of the Wall Street scandals of the 1980s but never really went away.

Many people were never called to account, and many practices apparently escaped the attention of New York's attorney general, Eliot Spitzer, and the Securities and Exchange Commission. No one ever explained what really went wrong, nor did anyone follow the chain of responsibility for these actions as high as it might go. Many of the worst transgressions that make our markets grossly unfair went unpunished and uncorrected.

Hence this book.

IT IS A BOOK that will take you into the inner sanctum of Wall Street, a book that I hope will open a door to a new world in the same way a new world opened up to me when I took my first job as a Wall Street analyst in 1989 and soon received the first of many cryptic calls:

"Come immediately to a meeting, Dan. Don't let anyone, not even your staff or your family, know where you're going."

At such meetings, it would become clear that a company was about to undertake a major move such as a merger, an acquisition, or a big financing with the help of my investment bank, and that the company wanted my advice. On Wall Street, this experience was called going "over the Wall," referring to the "Chinese Wall" that was supposed to keep confidential, inside information obtained by an investment banker from falling into the hands of someone who could use it for unfair gain. I went over the Wall many times in my career. And this book will bring you over the Wall, too—the wall that conceals and protects how Wall Street *really* works.

As I write, the telecom and financial worlds are showing signs of life. A few stocks, such as Google, the Internet search engine, are defying gravity once again. Investment banks have restructured in an attempt to keep analysts from the types of temptations and conflicts of interest that brought their firms numerous lawsuits and billions in fines. Boards of directors have been reshuffled. Ethics policies have been implemented and laws changed. Some of the most lurid corporate scandals of the early twenty-first century, from Tyco and Adelphia to WorldCom and Enron, have finally reached all the way to the tops of those organizations, thanks in part to the zealous efforts of government prosecutors. And mega-billion-dollar mergers in the telecom industry once again headline the news.

It seems like a whole new world. And indeed, it is certainly true that the Street has changed in some ways, ways that make it a little less vulnerable to overt fraud. It is also true that some executives of some corrupt companies are finally being brought to account and that investment banks and the analysts who work for them are under much more scrutiny than ever before.

But let's not be fooled. There remain many conflicts, leaks, and abuses of the law—and of investors' trust—that have never been exposed. No one has fully explained why the remedies offered and prosecutions undertaken thus far will not solve the problems inherent

on Wall Street. No one has fully explained how investors play on an unbalanced and unfair playing field, a field that individuals and even many professional investors have no business playing on at all. And no one has explained how crime paid—and paid big—for the majority of people who broke the rules.

Nor has anyone exposed the unfair, often illegal use of inside information. The misuse of inside information grew out of control during my years on the Street, but no one has successfully pursued its abuse, not even Eliot Spitzer, one of the most aggressive investigators of corporate wrongdoings in history.

Sometimes the beneficiaries were professional institutional investors. Sometimes the benefits flowed to Wall Street analysts, who used inside information to parlay themselves into positions of power and influence in the stock market. At other times, it was corporate executives, whose advance knowledge of coming troubles let them cash out of their company's stock ahead of all other investors. This insider's game was never fair, not even for the professionals, who might have gained an edge in some situations but found themselves shut out in many others. Above all, it was—and remains—most unfair for the individual investor.

In the pages that follow, I'll share my front-row seat at one of the most dramatic—and ultimately tragic—periods in financial history. I will share details of life on Wall Street that few can risk disclosing for fear of implicating themselves. I'll explain what it was like to be at the epicenter of the most dynamic industry in a highflying stock market, sparring with fellow Wall Streeters Jack Grubman, Henry Blodget, and überbanker Frank Quattrone; telecom CEOs like AT&T's Michael Armstrong, WorldCom's Ebbers, and Qwest's Joe Nacchio; and Street bosses such as Merrill Lynch's David Komansky, Morgan Stanley's John Mack, and CSFB's Brady Dougan.

I'll show a Wall Street that was a jungle of greed and ego, a place brimming with conflicts, and a place that was absurdly out of touch with the Main Street it claimed to serve. It was an environment in which pay levels spiraled out of control, where 30-year-olds earned seven figures, and where no one noticed an extra $1.5 million inadvertently inserted into my own employment contract. It was an environment in which an insider tip could yield billions of illicit stock market gains without anyone else knowing. It was an environment in which an obscure ruling by the Securities and Exchange Commission (the government agency responsible for the integrity of the financial markets) sparked what I believe was the biggest wave of Wall Street

conflicts of interest ever. And it was an environment in which ethical standards had fallen so low that not only was it difficult to do the right thing but often it was difficult to even discern the line between right and wrong.

What you'll learn in these pages is sometimes ugly, but it is all true. While writing this book, I have had to relive many of the decisions, judgment calls, and ethical choices I made. Sometimes those memories have made me smile with pride; other times, I've cringed with embarrassment. Some of the stories are outrageous, others hilarious, and many are simply absurd. Such was life inside the telecom bubble.

LOOKING AT BERNIE'S BACK, I wondered what was about to happen to him. I wondered, too, about Jack Grubman. Jack was my fiercest rival and the analyst who parlayed his advocacy of WorldCom and his close association with Bernie Ebbers into a position of power that made him the most influential analyst on Wall Street for much of the 1990s. Jack and I were brutal competitors, so obviously I can't be completely objective, but I do believe that he personified much of what went wrong at the intersection of Wall Street and Main Street. Now he, too, was gone, having resigned under a cloud of scandal and having been banned from Wall Street, but without ever being charged with any crime or brought to trial.

With the verdict now imminent, reporters scurried across the room to their preferred positions, some near the jury, some sitting behind Bernie and his defense team, and some poised to run outside to the TV cameras and trumpet the news to the world. The sketch artists opened their easels and sat poised to capture the moment in its most lurid details.

I glanced over at Kristie Ebbers, who sat with her arms around her daughter Carly. Bernie was now standing up straight, facing the jury box, praying to his God, I supposed. His face was totally impassive. You'd never have known he was waiting to find out whether he'd be walking out of this courtroom a free man or spending the next few decades in prison.

At 12:30 PM, Judge Barbara Jones, an even-keeled former federal prosecutor, came out of her chambers. The jury filed in slowly. I scrutinized their faces, looking for clues. Not one of them looked at Bernie.

“Have you reached a verdict?” Judge Jones asked the foreperson, a serious, middle-aged woman named Theodora Evans.

“Yes, we have, Your Honor.”

“May I see it, please?” The clerk brought the envelope to the judge, who opened it, pulled out two pages, and read them to herself for a seemingly interminable sixty seconds. Judge Jones gave it back to the clerk.

“Ms. Evans, you are the foreperson of the jury,” Judge Jones said. “Would you please answer the following questions for the court: How does the jury find Mr. Ebbers on count number one, conspiracy?”

“Guilty,” Ms. Evans said, her voice low and strong.

The courtroom went absolutely, totally silent. I looked at Bernie and then at Kristie. Both were staring into space, their faces masks, motionless and emotionless.

“How does the jury find Mr. Ebbers on count number two, securities fraud?”

“Guilty, Your Honor,” Ms. Evans said.

“Count number three?”

“Guilty, Your Honor.”

Tears began to spill out of Kristie’s eyes. She didn’t have any tissues. Small rivulets streamed down her face as she stared at the back of Bernie’s head. Carly put her arms around her mom’s waist. Bernie continued to stand up straight, his face blank. I couldn’t believe his legs were still holding him up. His lawyer, the folksy, ultraconfident Reid Weingarten, sat next to him in shock.

Bernie was found guilty on all nine charges.

As the judge and jury filed out of the courtroom, some people looked vindicated, others stunned. Bernie picked up his coat and embraced Kristie and Carly. As the three of them passed me in the aisle, I tried to empathize, but I kept recalling that his company’s fraud had helped to bring down my industry and ruin the livelihoods and retirement dreams of hundreds of thousands of people. Though he seemed to be unaware of what was going on around him, he turned

and shook my hand.

As the Ebbers family exited the courthouse and slowly trudged the half block up to Centre Street to catch a cab, crowds of cameramen and reporters hounded them. Bernie Ebbers, a man who once had private jets, drivers, and handlers, was exposed to the jeers of passersby who had heard the news.

“You should fry,” one yelled.

“Do you know how many lives you destroyed?” bellowed another.

“You got what you deserved,” a third muttered to himself.

The king of the shining new world of telecommunications had a new identity: the king of white-collar crime.

But while the world finally saw justice served in the story of WorldCom, the jury is still out, in my view, on the telecommunications industry, which burned so brightly and sucked in so many people before it turned into the deepest of black holes. Moreover, the jury is also still out on the responsibility of the Wall Streeters who aided and abetted the rise of these companies and then simply got out of the way when they collapsed, at most paying only a few modest fines. And it’s still out on the insider game that I was a key part of, a game that the average investor—and even many of the professionals—can never win.

I’m sure you will arrive at your own verdict after reading the pages that follow.

1.THE PLUNGE

1989–1991

Ed picked me up at my house in a taxi. My home, at the time, was nothing super fancy, but Paula and I had put a lot of sweat into it and were quite proud of it.

Ed took one look at the house and almost started laughing. "You ought to come to Wall Street and hit the big time," he said.

JULY 14, 1989

"This Is the Street Where They Fool People."

THAT'S WHAT I WAS THINKING as I stepped off the early morning express train from Scarsdale and stood on Madison Avenue, blinking nervously in the bright sunlight. As I gazed up at the rows of tall buildings and tried to avoid colliding with the natives, I felt the tiniest sense of relief.

At least my job was on Wall Street. Madison Avenue, by contrast, was the center of the advertising world, the place where smart and manipulative companies burned loads of cash and creative energy to convince us that we needed to wash our hands with Dial, brush our teeth with Colgate, and wipe our derrières with Charmin. At least I was going to be an analyst whose job it was to evaluate companies on their merits, not someone whose raison d'être was to seduce America's soap-opera watchers with meaningless slogans and exaggerated promises.

My new job in equity research, I believed, had nothing to do with manipulation and everything to do with balanced, rational thinking. I had made the leap to Wall Street in part because of the money, but also because being an analyst seemed like the perfect job for a serious

guy like me who liked to reason his way through life. Sure, emotion and hype sneaked into my line of work occasionally, but in the end, the stock market was rational, analytical, cool. Fooling people wasn't part of *this* equation.

Or so I thought. In retrospect my naïveté sounds charming or—let's not be charitable—silly. *Of course* Wall Street was as much about fooling people as Madison Avenue was, at least if you were one of the corporate executives trying to convince investors—and analysts—that your company's shares would shoot to the moon. But my job, I hastened to tell myself, was all about shooting straight. I had been in a sales role before, and I'd never liked it. Now I'd have a chance to focus entirely on the facts.

I grabbed on to that belief as if it were a life preserver and clutched it as I walked up Madison, then west on Forty-eighth Street and north on Sixth Avenue until I reached the headquarters of Morgan Stanley at Fiftieth and Sixth. I was 36 years old, it was my first day on Wall Street, and I was scared out of my mind.

Not that I had fallen off the turnip truck or anything. I had moved here from Washington, D.C., where I had been director of business analysis at MCI, the brash upstart that was shaking up the telecommunications business. I had interacted with Wall Street and its analysts and bankers for the past two years, trying to make them see my company as positively as I did. What I loved the most was the intellectual sparring as we debated the future of MCI and the telecom industry. It had been a great gig.

But this was the big time. I had been recruited by one of the premier investment banks, a place better suited to Brooks Brothers–clad Greenwich bluebloods than a middle-class public school guy from Buffalo, New York. I was going to be one of a select group of some 35 analysts at Morgan Stanley whose job it was to recommend stocks—and, I had been told, move the financial markets. The prestige and power of my new job filled me with pride. But the responsibility terrified and humbled me. All of a sudden I was in the major leagues, and I'd never even played Class A ball. What was I doing in the middle of this?

Already, I'd ventured pretty far from my beginnings as the son of a scrap-metal dealer with a high school education. I'd been a political science major and math minor at the State University of New York at Albany, where I'd met my wife-to-be, Paula Zimmer, during a Wiffle ball game on the first day of our second year. She studied art history

and then went back to school to become a pediatric-intensive-care nurse. And I'd gone on to become a starry-eyed graduate student of Middle East politics at the University of Chicago and Princeton University, certain I wanted to devote my life to bringing peace to that powder keg of a region.

I ended up at the LBJ School of Public Affairs at the University of Texas, earning a master's degree in 1979. I was hoping for an assignment that involved foreign policy but instead accepted a $24,000 offer from Coopers & Lybrand, one of the world's largest accounting and consulting firms, as an economic consultant in its Washington, D.C., office. For a few years, I was really happy at Coopers. The job appealed to my inner wonk, and I worked my way up the food chain. But once I was promoted to manager, my job became more and more about selling new consulting services to clients. The whole selling thing turned me off. I didn't want my life to be defined by the spin and hype of selling. Working *inside* a growing company began to sound a lot more interesting.

From Consulting to Communications: MCI

It just so happened that the Coopers's D.C. office building backed up against the new offices of MCI, an upstart telecommunications company that had been in business since 1968. MCI had emerged as a young, exciting David to AT&T, the ultimate corporate Goliath, with a more responsive, entrepreneurial culture. Its founder, Bill McGowan, had found a way to compete against AT&T in the long distance market even before the November 1982 court order that would break up the monopoly Bell system into AT&T and seven companies that became known as the Baby Bells. MCI had grown wildly in the early 1980s, quadrupling its sales to $400 million between 1979 and 1983.

I knew a few former colleagues from Coopers who had gone over to MCI, and decided it sounded like a great opportunity. MCI made me an offer to work in its finance department, though it would mean a 10 percent pay cut from my current salary of $38,000 to $34,000 and the end of my rise up the Coopers & Lybrand partnership ladder. I talked it over with Paula, and although it was going to be tough for a while, she agreed that the potential to work at a fast-growing, dynamic company was worth giving up some salary in the short-term.

Most of all, I wanted out of anything to do with sales and marketing. I was a cerebral type who liked reasoning through complex issues rather than trying to turn everything into a slogan or sales pitch. It would become a familiar refrain in my career, and an ironic

one too. Every time I tried to escape the sales aspect of a job, I made a move that brought me closer to that world.

But I didn't know any of that then. I was 30, with a wife, a two-year-old daughter, and another baby on the way—no longer an idealist seeking world peace, but no cynical sellout either. So I started at MCI in 1983 as a capital-budget analyst, which essentially meant that I reviewed all the requests for money from around the company and recommended approval or rejection. It was a classic middle management job, but it was exciting work in a company like MCI. Within four years, I had become the senior manager of budgeting and planning, doing nuts-and-bolts financial stuff that was right up my alley. And then, in 1987, I got a call from Bill Conway, MCI's wunderkind 36-year-old chief financial officer. He wondered whether I'd be interested in a job in the investor relations department as the liaison between MCI and the Wall Street analysts who now covered us.

Every time a new industry came along, Wall Street staffed up with analysts, traders, and bankers to cover it. And while telecommunications wasn't new, the number of publicly traded telecom stocks was about to triple. In 1984, what was just one company—AT&T, or "Ma Bell"—became eight when the Bell system was broken up in an antitrust settlement with the U.S. Department of Justice. It was a decision that would usher in a new world of competition, major technological advancements, and billions and billions of dollars in new investment.

There were now eleven major telecom companies—AT&T, the seven Baby Bells, GTE, Sprint, and MCI. Former AT&T shareholders were given shares in each of the Baby Bells and, of course, in the new AT&T, which now provided long distance service and manufactured telecom equipment. These companies, now publicly traded, were suddenly vulnerable to the vicissitudes of the stock market, and Wall Street desperately needed people who could help investors figure it all out. So in the early 1980s the Street went on a hiring binge, recruiting practically everyone it could find with experience in both financial analysis and the telecom sector.

These analysts were a small but elite group of people who researched companies' publicly traded stocks and made recommendations to investors on whether or not to buy them. They studied companies in their area of expertise by doing everything from analyzing the financial trends in an industry to interviewing the top executives to gauging the impact of upcoming regulatory changes.

There were two kinds of analysts, each with different responsibilities. The first group, some 500 strong in total by the late 1980s, worked for investment banks like Morgan Stanley or Goldman Sachs. They published their research in reports that were then "sold" to outside investors from large pension funds, mutual funds, and other large institutions, which is why they were known as "sell-side" analysts. In practice, these reports were not really sold; they were given to the institutional investors in exchange for the fund managers buying or selling stocks through the firms with the most helpful research. At some banks, brokers in the "retail" arm of the business would also provide this research to individual investors. The sell-sider had to walk an odd sort of tightrope, providing research that was supposed to be completely independent of any banking business his employer might do with the companies the analysts covered.

The second group of analysts, a much larger but not as well-compensated group, worked directly for the large institutional investors that bought the sell-siders' research. Their job was to recommend which stocks their employers should own in their portfolios. They were known as "buy-side" analysts because their firm would "buy" the "sell-siders'" research. Although these analysts made their own investment decisions, buy-siders certainly read sell-side research, and sell-siders catered to them as their clients. Buy-siders didn't publish their own research, however, and had no responsibility to investors outside their own firms. The only master they served was the large pension-, mutual-, or hedge-fund manager that employed them.

My new investor-relations job at MCI, if I took it, would be to pitch MCI to both of these newly minted groups of research analysts. That meant explaining MCI's strategy, providing financial information, interpreting regulatory decisions, and doing whatever was necessary to help these influential people make their investment decisions. Hopefully, of course, their opinions would be favorable toward MCI and their firms would buy MCI's stock, which would make my bosses happy and anyone who owned MCI shares richer.

My first reaction was that it was basically a public relations job, and PR was definitely not my forte. But MCI's CFO, Bill Conway, whom I liked a lot, kept after me, and I finally decided that it would be good for me to try it. After all, the job did have some advantages, one of which was its location on the company's executive floor. I figured I'd have a lot more interaction with the top brass and in the process learn a lot about how a rapidly growing company is managed.

In early 1987, it was also a tougher job than it had been. In December 1986, MCI had taken a huge write-off and the stock had crashed from over $20 to under $5 per share after a disastrous acquisition of a satellite company. Investors had lost enormous amounts of money; they felt betrayed and angry. The previous two-person investor relations team had been shunted aside, virtually run out of town by rabid institutional investors seeking vengeance. Though they clearly were not responsible for the company's misfortunes, many professional investors felt that the previous team had spun a misleadingly bullish story just as that acquisition was going south. So, at this point, the investor relations job was more about damage control and reestablishing the company's credibility than anything else.

I was assigned to work with Jim Hayter, a tall, lanky regulatory troubleshooter who started in 1972 as MCI's 85th employee. Jim was a true extrovert; he loved to interact with people and had an innate ability to find out what makes someone tick. He used self-deprecating humor, a beguiling yet devious smile, and a deep-throated, sometimes-forced laugh to disarm people. He had a way with the ladies too.

We made a great tag team: I taught Jim the ins and outs of financial analysis and forecasting, and he taught me about regulation and market psychology. Coming from within the bowels of the company's financial organization, I had good knowledge of what internal factors drove the company's future, and I also had solid sources inside MCI's financial, marketing, and engineering organizations. They gave me credibility with Jim and, more important, with Wall Streeters as well.

We divided up the analysts we'd each handle, more by personality type than anything else. As the stoic member of this dynamic duo, I dealt with the more analytic and empirical analysts, like Ed Greenberg at Morgan Stanley and Robert Morris at Goldman Sachs. Jim got the ones who were more intuitive and, shall we say, *emotional.* I marshaled facts to explain the merits of MCI's strategies and earnings prospects, while Jim used psychology to entice investors into buying MCI shares.

My First Run-in with Jack Grubman

Jack Grubman was one of those emotional sorts. Jack was a PaineWebber analyst who had left AT&T for the Street in 1984. He was loud, opinionated, and seemed to exaggerate everything in order

to make it sound more dramatic. He had a somewhat high-pitched, nasal voice, two large front teeth, and a receding hairline with jet black hair. Most Wall Street analysts were, well, analytic; their reports were as dry as a day-old turkey sandwich. But Jack punctuated his dispatches with the written equivalent of a scream.

I had met Jack recently when MCI CFO Bill Conway, Jim, and I had done the rounds on Wall Street, visiting with each of the major investment banks' telecom analysts. Like me, Jack was a bit of a wonk, having studied math as an undergraduate at Boston University (though he claimed his degree was from MIT) and then earning a master's degree in probability theory from Columbia University. AT&T recruited him into its management training program. After the breakup of AT&T into eight separately traded stocks in 1984, PaineWebber recruited him to be its analyst for the new telecom services sector.

Jack came to Wall Street with a deep understanding of the regulatory changes underway in the industry, as well as a great background in telecom engineering. He went out of his way to flaunt that engineering knowledge in the reports he wrote. A middle-class guy from Philly, Jack made much of his supposed rough beginnings and loved to remind people that his father had been a boxer and that he, too, liked to box for fun. Although his nose hadn't been flattened yet, there was an in-your-face quality about Grubman that made you pay attention.

My first noteworthy interaction with Jack came in March of 1988. We in investor relations got word that he had written a negative report on MCI. I had to scramble to get a faxed copy from a buy-sider who owned lots of MCI shares and was panicked about the report's allegations. Using a heap of technical jargon that no one in the investment world could make head or tail of, Jack argued that Sprint's network was far superior to MCI's and that MCI had chosen the wrong technical path, with potentially disastrous implications. "We think Sprint will do to MCI what DEC did to Data General, surpass a supposedly better competitor by having superior technology," he wrote.[1] Dense with detail and layered with so much techno-speak as to make it unintelligible yet impressive-sounding, the report had the effect of dissing MCI without anyone understanding exactly why. It was a technique Jack would use again and again on the Street: overwhelm everyone with technical stuff and therefore make everyone else's research appear shallow—and uninformed—by comparison.

The president of MCI, Bert Roberts, read the report and went

ballistic. “This jerk is not just saying he doesn’t recommend our stock,” he fumed, “he’s basically telling the world that we don’t know what the hell we’re doing!” Bert, an engineer by training, said there were tons of errors in the report. He told Jim and me to counter Jack’s “crap” with the facts and to make sure the buy-side and other sell-side analysts did not believe his conclusions. Longer term, we obviously needed to turn this guy around to our line of thinking. So while we would certainly try to discredit what was inaccurate, we’d also play a little bit of good cop–bad cop, wining and dining him and trying to change his attitude. That was the plan, anyway.

Jim assigned me the task of dissecting the report and countering it point by point. My first move was to meet with MCI’s own engineers and come up with a list of inaccuracies. I found lots of them. Armed with my talking points, I called Jack.

“Look,” I said, trying to keep my voice cordial, “I’ve talked with our engineers, and I’d like to run through a bunch of things with you.” I went through about six or seven points, explaining how his report stated that we were doing the opposite of Sprint when in fact we were actually using the identical technical approach. Jack listened carefully, or at least that was my impression. To my surprise, he didn’t even really try to debate me. “I’m really sorry,” he said, although he didn’t sound very apologetic.

“How did you get this information in the first place?” I asked. “Why didn’t you at least run it by us to see whether it was true before publishing the report?”

“I ran it by an engineer friend at AT&T,” he said, without a trace of shame. “He said it was a great report.”

Now, I’m a pretty calm guy, but I almost lost it when I heard that. He had relied on someone who worked for AT&T, a competitor that would do almost anything to discredit our long distance service. Was this how Wall Street research was done, by relying on biased sources and unchecked assumptions?

I was angry, but for a different reason than one might think. Of course, Grubman’s report would hurt MCI and make our jobs tougher. Even if he wrote a clarification, it would be difficult to erase the impression that he had created in the minds of the brokers at PaineWebber, who had already been fed summaries of Jack’s conclusions, as they were with all research reports. They had already taken those summaries, chewed them up into even tinier bits, and, like

a herd of cows with their cuds, redigested them for PaineWebber's masses of investor clients, down to one basic message: MCI is in deep trouble; dump its shares.

As irritating as that was, what offended me the most was the notion that Jack Grubman was more interested in making a splash than in really understanding what he was writing about. I couldn't believe that he was willing to sign his name to research so shoddy. I would have been mortified if someone corrected me like that, mortified that people would think that my analysis and research were shallow and misleading. But maybe this was my own insecurity coming to the fore. I had always been the one who outresearched or outstudied everyone else rather than wowing people with quick answers or brainpower. I'd never been the genius—not in high school, college, or at work. Rather, out of necessity I suppose, I simply tried to work harder and dig deeper than anyone else.

So I couldn't really help myself as I listened to Jack's grating voice and heard that feigned apology. "This is embarrassing for *me,"* I said, turning red. "I'm a Chartered Financial Analyst (CFA) and I'm embarrassed to be part of a profession that has people like you doing research that is so misleading and irresponsible." Jack responded with a series of condescending mumbles to the effect that I didn't have a clue about how Wall Street worked, that he was simply doing what he was paid to do and, given the huge amount PaineWebber was paying him, he must be damn good at it. We hung up. He didn't change his report, though, fortunately, it had less impact than we'd feared. I had had my first clash with Jack Grubman.

Street Smarts

Despite my troubling experience with Jack, I came to really enjoy the investor relations job and my interactions with the wild, fast-paced world of Wall Street. I quickly learned that investor relations was more of an art than a science—especially when it came to managing the analysts' earnings expectations. Knowing how companies did this was a skill that would serve me very well later, when I moved to the Street.

Bert Roberts, MCI's president, believed that it was critical that MCI's shares trade higher on the day of quarterly-earnings releases. This was because the next day's press coverage would be enthusiastic if we met or beat expectations, and full of fawning quotes from the analysts that followed us. But if we missed the Street's earnings expectations *and* our stock price fell that day, the articles would be

negative and critical. This, Bert believed with good reason, would influence customers' perceptions of MCI as a stable supplier of telecom services. The more positive the press coverage, the easier it would be for a corporate telecom manager to buy more services from upstart MCI rather than old, reliable AT&T. So that meant that those of us in investor relations had to try to make sure that the stock reacted positively on earnings day.

In practice, that meant two things. If it had been a bad quarter, we needed to leak that information slowly and quietly, so that the stock would drop during the week or two before the earnings announcement, but without generating any media attention. That was a lot better than the stock plummeting on earnings day, when the world was focused on it. Positive news would also be leaked but downplayed a bit, so that the stock would still see a decent bounce when the better-than-expected news hit. It was a common practice, so common that I didn't even take note of it at the time. (The SEC's Regulation FD, for Fair Disclosure—which required that all financial information be released to everyone at the same time—wasn't passed until 13 years later.) Yet it meant that some people benefited, while others, primarily small investors, never knew what was going on. It was simply, I learned, part of the game.

Sometimes getting that news out meant making just a few calls to the analyst community. If we felt the Street's earnings projections and thus MCI's stock price were too low relative to what we were likely to deliver, we often would call two or three top sell-side Wall Street analysts. The conversation would go something like this: "Hey, Robert [Morris, Goldman Sachs's top-rated telecom analyst]. What's going on? We haven't talked in a while." Knowing exactly what was up, Morris would say, "You know, I've got my model here in front of me and I wondered if my revenue growth projection of 25.3 percent this year was within range." We would then launch into a little game of "warmer," "colder," until Morris "divined" that his quarterly projection for MCI's earnings per share was a penny or two too low. He'd thank us, hang up, and call his sales force to announce that he had just spoken to management (i.e., me) and that he felt good about how the quarter was shaping up, so he had decided to increase his MCI forecast. Brilliant.

We'd usually call two or three analysts at about the same time, but Morris was consistently the first to call back and the first to get his updated forecast out. Like magic, when the NASDAQ opened at 9:30 AM, MCI shares traded up. By the time the other analysts called back,

Goldman's sales force had informed virtually every buy-side analyst and portfolio manager in the Western world of the new forecast. And then the other sell-side analysts—the ones we hadn't called—would start getting calls from buy-side clients asking what they thought of Goldman's earnings increase and what, if anything, they had heard from MCI.

They'd flood our phone lines, and we'd simply say that Morris had been going over his model and increased it. "That seemed okay to us," we'd say. They then revised their estimates, and the boost to our stock price caused by Morris's earlier update held firm. If you were among the largest institutional money managers, you had it made. If you were an individual investor, you were inevitably too late to the party; the stock had already risen and you'd missed its move.

On the other hand, if the news was bad, we might also call a few of the most influential analysts, but, more often, we would pack up and, with minimal notice, fly to Boston for a day of meetings. Boston was where the largest and most powerful mutual funds were located, companies such as Fidelity, Putnam, and many others. We always booked Fidelity first, at 8:00 AM, and then usually Putnam at 9:30 AM, followed by Wellington, MFS, State Street Research, and other large institutional investors.

The meetings were almost always the same: with a group of 15 or so Fidelity portfolio managers, including the famous Peter Lynch, watching, Fidelity's telecom analyst would run us through a grueling series of questions regarding every line on MCI's income statement. Fidelity's portfolio managers paid attention to every word we spoke, every number that left our lips, even our tones of voice and facial expressions. Eventually, it would dawn on someone that we were guiding down our earnings estimates, at which point the Fidelity portfolio managers would suddenly bolt out of the room, hustle down to Fidelity's trading floor, and tell their in-house traders to sell MCI shares when the market opened at 9:30 AM. Brilliant again.

These various Fidelity portfolio managers, armed with an inside edge that no one else had, would now be racing to unload their MCI shares ahead of their competitors at other money management firms. FIDO, as the Street called it, wouldn't exactly *make* money on a morning like this. Rather, it wouldn't *lose* money when the stock fell on our bad news. Many others did lose money, however. They were the ones buying the shares that Fidelity was unloading at 9:31 AM.

It was a fate that other institutional investors couldn't avoid. And

the little guy, the individual investor, the retiree? If they owned a Fidelity mutual fund, it worked to their advantage—this time. No wonder Fidelity was the country's investment darling. But if they didn't, they were out of luck. It was my first lesson that life on the Street, with its uneven information flows, often rewarded the powerful and connected over the merely smart. It distorted the entire market in the process.

Ed Comes Knocking

By mid-1988, my new career was working out well. I didn't feel like I was changing the world, exactly, or bringing peace to it, but I *was* working for a company that was doing some good by making phone calls cheaper and improving the quality of phone service. Plus, I was now making $70,000 a year. By my standard of seeking work that I found intellectually interesting, it was working out well. And by my more practical standard of earning a decent living for my family, I was content too.

Over time, I had developed a good working relationship with some of the other analysts, particularly Ed Greenberg, the telecom analyst from Morgan Stanley. Physically, there was nothing impressive about him—he was a shortish and baldish guy—but his brain was something worth celebrating. He was one of the smartest people I'd ever met, with an incredible analytical ability but also a variety of other intellectual interests ranging from theater to music to baseball. Even in his forties, he still joked that his dream was to play center field for the Yankees.

According to *Institutional Investor,* a magazine that ran what I thought at the time was an obscure survey of buy-siders, Ed was the number-two-rated Wall Street telecom analyst, behind Goldman's Robert Morris. I was vaguely aware that the ranking meant a lot for analysts in terms of their compensation, and that we in MCI's investor relations department needed to provide special care and feeding for the top vote-getters, since they were, as that famous line from George Orwell's *Animal Farm* goes, more equal than others. But I liked Ed, not because of his ranking, but because of the way he thought. He figured out trends in telecom two or three years ahead of anyone, often even ahead of the chief executives and chief strategists at the companies he covered. In fact, he was so prescient that he often recommended investments far too early.

Unlike that Grubman guy, this was someone whose approach to Wall Street research I appreciated. Ed was a deep thinker and

extraordinarily thorough in his analytic work. He also was a no-bullshit kind of person who told you what he thought and why. And he was really good at the other side of the Wall Street job—interacting with buy-side investor clients and executives of companies like mine.

At the time, I only vaguely understood that being an analyst required a bit of socializing too. Not only were you wined and dined constantly by the companies you covered, all of whom hoped desperately to convince you to say positive things about their company and its stock, but you in turn had to market yourself—and your research—to as many professional analysts and money managers as time would allow. Your reputation didn't come only from the quality of your thinking, I later learned, but instead that was just one piece of a jigsaw puzzle that included how responsive you were to a client's questions, how well clients liked you, and what kind of special tidbits you could dole out to them to make them feel special and appreciated. Basically, you had to be smart, you had to work your tail off, *and* you had to be popular. It reminded me of high school.

In November 1988, Ed proposed that Morgan Stanley sponsor a European investor-relations "road show" for MCI. A road show for a company was a marketing trip in which its executives traveled around the country or the world, meeting with investors and, hopefully, convincing them to buy its stock. Acting as a friendly adviser, Morgan Stanley had offered to arrange meetings with the largest mutual and pension funds in each of Europe's major cities. Morgan's salespeople, along with Ed, would chaperone us around from meeting to meeting, telling our story.

Jim convinced MCI's new CFO that the trip made sense, since MCI needed more visibility in Europe and it would be good to be sponsored by an analyst and firm as well-respected and bullish on our shares as Ed Greenberg and Morgan Stanley. We offered Ed a ride on MCI's corporate jet, a Falcon 50, and he accepted, naturally; six hours in the air with MCI's CFO was an analyst's fantasy, not only an opportunity to learn lots of new things about MCI and its strategy, but an experience he could layer into every conversation he had with his large investor clients, thus enhancing his reputation as a "well-connected" analyst.

So that Monday morning, Ed picked me up at my house in a taxi. My home, at the time, was nothing super fancy, but my wife, Paula, and I had put a lot of sweat into it and were quite proud of it.

Ed took one look at the house and almost started laughing. "You

ought to come to Wall Street and hit the big time," he said. "I'm serious. You'd be good at it, you'd make plenty of money, and you'd get to do analysis all day long instead of just parroting management bullshit."

Parroting management bullshit? I was offended—until I realized that he was absolutely right. That was exactly what I'd spent much of the last year and a half doing in investor relations. My job was not to express my own opinions but rather to pass on the company's party line.

Our trip to Europe was a blast, made even more fun one day by the fact that the Morgan Stanley salespeople had arranged for us to be chauffeured in a sleek black Bentley, complete with a wonderfully obsequious driver. Even by Wall Street's standards, this was over the top. I started to wonder exactly how much money Wall Street analysts made, anyhow. What they did didn't seem any more difficult than my job, and it did sound more appealing to be the one whose opinions moved markets rather than the one who had to react to those opinions. I figured if I could be about 30 percent as smart as Ed and 20 percent more practical, I had a chance to do all right on the Street.

I knew the basics of how an investment bank worked, but not much more than that. My understanding was that they advised companies on strategic and financial issues and raised money for companies by selling stocks and bonds, taking a piece of the proceeds. And they worked with investors, helping them select investments, matching up buyers and sellers of securities, and charging a commission on every trade.

But I had no desire to move up to that snake pit called New York. I was fine in D.C.; Paula had a good job, and we now had two young daughters. By early 1989, I was promoted to director and put in charge of MCI's business analysis group, running a group of MBAs analyzing everything from how to price a new MCI service to how much to spend on new technologies. But then Ed came back to me, telling me that he was rethinking his own career. Because Ed was so smart, he was also easily bored, and he was bored with being an analyst after so many years. He wanted to do something different. He decided to become a banker.

"Come work at Morgan Stanley," he cajoled, "and take my job. I'll train you and make you as good as me." I told him I wasn't moving. The cost of living in New York was way too high. Ed just laughed. "Just come up here and meet the people," he said.

So I did. In fact, I took two trips to meet various research managers and institutional salespeople at Morgan Stanley. I'd been told that Morgan Stanley was a white-shoe investment bank that advised many of the largest and best companies in the world. It had a reputation of being genteel, refined, and snooty, with an old-money sensibility about it. Morgan Stanley didn't trample all over people trying to bring in business like some banks did. It didn't have to.

I enjoyed myself during these visits to Morgan Stanley. The meetings convinced me that the job would be fascinating and fun and that, with Ed's tutelage, I could probably do it. I didn't meet anyone from the banking side: apparently they didn't care who replaced Ed as telecom analyst. I really had no idea what bankers did or why they might matter. My vague notion was that bankers made the lion's share of the dough on the Street and that their job was the most prestigious. They served as advisers to the top executives at top companies, helping them to find other companies to acquire or merge with and raising money for them. It never occurred to me that they had anything to do with analysts, or that there was any significant interaction between the two groups. In any case, if Ed was interested in being a banker, they couldn't be all that bad.

At the end of my second visit, Peter Dale, Morgan Stanley's director of U.S. equity research, told me he would call me in the next few days with an offer. I still wasn't sure if Paula would be willing to move, or of how disruptive such a move and career change might be to our family and marriage. I'd read an article in *The Wall Street Journal* that said top-ranked analysts were making $250,000 and up. That seriously impressed me, but of course there was no guarantee I'd ever be a top-ranked analyst. Plus 1988 had been a bad year on Wall Street. The stock market had been flat and investment banks had been in the tank. So when Peter called with my offer, I held my breath. "We'll start you at $150,000," he said. That meant $75,000, plus a $75,000 guaranteed bonus. My heart raced; he was doubling my salary.

Paula and I had calculated that it would take $175,000 to replicate our D.C. lifestyle by buying a similar-sized house in a comparable school district. This magic number also meant Paula could stay home with the kids, a luxury we hadn't had until now and one we might need given the grueling travel schedule of a Wall Street analyst. For days, Paula and I stewed over how to handle the negotiations. Would I blow the deal by asking for another 25 grand? What if they wouldn't give it to me? Could I still accept the job or would I have lost face? It seemed so, well, forward to ask for more. But that was the way it

worked up there, wasn't it?

I called Peter and nervously laid out my proposition. "This is the right job for me," I said, trying to sound cool. "But," I said, speaking like the true quant guy I was, "it's tough to make the numbers work." I needed another $25,000, I croaked.

"Okay," Peter said, as if he'd just been asked to pass the salt. "Fine." He didn't have to ask anyone for permission; there was even the hint of a smile in his voice. Geez, was I clueless about the scale and scope of life on Wall Street. Apparently, $25,000 was the equivalent of a sneeze up there. "Dammit!" I said to Paula. "I didn't ask for enough!"

Although I was excited about the money, that wasn't why I was uprooting my family. To some it may sound disingenuous—everything on Wall Street, I was soon to discover, *was* all about the money—but for me that was never truly the point. Sure Ed loved to tease me, saying, "Dan, I drive a *Beemer.* What do you drive?" (I drove a four-year-old Chevy Nova and Paula drove a Pontiac 6000 station wagon.)

The money was certainly appealing. But it was more about the intellectual challenge and avoiding that malaise, that blah, that *woulda-coulda-shoulda* of making the safe choice. I could stay on at MCI, but my next job was probably going to be managing the accounts payable department, made up of 300 clerks. The Morgan Stanley job, by contrast, was a chance to test myself against some of the smartest people in the world. I wanted the brass ring. I wanted to become a top-ranked analyst in that poll, whatever it was called. I wanted to take the challenge and I wanted to win.

If I needed any more assurance that I was making the right move, I got it when we had dinner with Steve and Gloria, neighbors of ours in Potomac. Steve was an economist at the Federal Home Loan Bank Board. He was smart, well connected, and, in my view, way too comfortable. Five years older than me, he was already thinking about the day when he could retire from his job as a government employee.

"Dan," he said, "you've got a great career going at MCI, you know all the top execs, and you have an extensive network of relationships throughout the company. Why would you give that up and start all over? You're not young anymore, you know. You're 36."

Suddenly, I had a flashback to my grad school days in public

policy, when I had planned on a career in government or academia, or even at a think tank. Like a lot of people who came of age in the early 1970s, I thought anything that smacked overtly of capitalism or the private sector was crass, tacky, bloodsucking. But in the summer between my first and second years at grad school, an internship at the Department of Education made me feel differently. Something had happened to all those idealists once they got into a slow-moving bureaucracy with job security. They had come in thinking they were going to change the world. Now they were 40 years old and hated their jobs. These guys had become bureaucrats through and through; as their idealism faded, their cynicism expanded. They no longer yearned to change the world, at the Department of Education or anywhere else. They were simply marking time until retirement.

On the ride home from dinner with Steve and Gloria, I said to Paula, "What Steve was saying was in a couple more years I'm going to be afraid of change and afraid of risk. I'll end up like him. I will never forgive myself if I don't at least give it a shot." We made the decision to move that night.

Breaking the news to my colleagues at MCI wasn't easy. One day, I ran into Orville Wright (yes, that is really his name), MCI's vice chairman, in the hall. He was a big, tall, bald, conservative, former IBM man who always wore a white shirt. When I told him my news, I expected the standard pat on the back, but instead, looking down at me (he was a lot taller than me), he said, "Dan, I sure hope you know what you're doing," as if he knew something that I didn't about the ways of Wall Street. Orville walked on without even congratulating me on what was the most important decision of my career.

A few days before my last day at MCI, Jim, my colleague in investor relations, came in and gave me a teasing look, that same look he used when he was looking for an impromptu audience for his latest tales of female conquest.

"Danny, I know how well you rise to challenges," he said. "I was just talking to your best buddy on the Street."

I rolled my eyes. "Which one might that be?" I parried, knowing full well who it was.

"I wasn't going to tell you this, because it might make it difficult for you to sit next to him in meetings," he said, "but Jack Grubman says you're not going to make it on Wall Street."

"Oh, really, why?" I queried. "Because I'm not a good liar or what?"

"Not exactly, Dan," Jim responded. "He said you'll never be able to handle the marketing and selling part of the job."

I laughed it off when Jim said that, but this was, of course, exactly the thing I was most nervous about. I didn't want to have to sell myself as much as my ideas. I was not an exaggerator or a cheerleader type. I'd never really been a backslapping, beer-chugging, frat guy. I didn't want to overplay everything in order to get attention, the way I thought Jack did. I simply hoped I could write reports from the quiet of an office overlooking midtown Manhattan as competently as any telecom analyst out there. Maybe Jack was right. But it was too late. I had already given notice at MCI and it was time to make the move. It was July 1989.

From the Jetway to the Attic

It turned out that $175,000 in Scarsdale translated into a house that was pretty darn similar to the Potomac house that my friend Ed had maligned. We bought a four-bedroom colonial that was maybe 300 square feet bigger but cost us $65,000 more than we sold the previous house for. It was one of the smaller houses in town, but it did have an attic—which I set up as an office. I had no idea how much time I'd be spending in it over the next several years.

My first few months at Morgan Stanley were remarkably free of the types of pressures that would later be splashed across the front page of *The Wall Street Journal.* My job was to cover telecommunications services—primarily the Baby Bells, which along with GTE provided local phone service, as well as AT&T, MCI, Sprint, and a few others that sold long distance service.

Ed was still the main telecom analyst at Morgan Stanley, so he just showed me to an office next door to his and told me to get cracking on my first report. I was to sit in that room, research the bejesus out of this industry, and come up with a groundbreaking report that would put my name on the map and bring the firm some attention. I didn't have to test my marketing mettle yet; I was just supposed to think, reason, puzzle. No one told me what to say, how to react, which companies were our banking clients, or anything else for that matter. Not even Ed, who had been positive on the Baby Bells, tried to sway me to his point of view.

I did, however, get my first taste of the good life in August 1989, when Ed took me on my first business trip to meet the top brass at the companies I was going to cover. Over the course of 10 days, we hit most of the Baby Bells, flying to Atlanta to meet BellSouth's top executives, to Denver for US West, to Washington and Philadelphia for Bell Atlantic, to Chicago for Ameritech, and to St. Louis for Southwestern Bell. This was a new, heady experience. I sat in the office of each CEO and asked the toughest questions I could come up with. They actually answered them too. It was a blast.

Even more of a blast was the way Morgan Stanley, unlike the utilitarian MCI, loved to spend its money. We traveled first class, stayed in the finest hotels, and ate at some of the most happening spots in the country. It would be unseemly not to; it was the Street, after all, and not spending the money implied you didn't have it to spend. Money begat money. My trip to San Francisco to meet with Pacific Telesis ended with a quick flight to Los Angeles to meet Tim Armour, the telecom analyst at Capital Group—next to Fidelity the largest and most important institutional investment firm on the Street—and his wife, Nina, for dinner. I knew Tim from my days in MCI's investor relations department, and Ed was quite close to him. We went to Chinois on Main, Wolfgang Puck's "It" restaurant of the 1980s, and found ourselves sitting next to Madonna. Tom Cruise was standing outside, chatting with someone. I tried not to gape and failed. Working on Wall Street didn't make you a Hollywood stud—yet.

The next morning, we flew back to JFK on MGM Grand Air, at the time an all first-class airline. Ed and I had a "stateroom"—four seats, facing each other, with partially drawn curtains—and the plane had a bar section with lounge chairs, each of which had its own airphone. I looked across the aisle and realized that in her own stateroom, with her own personal assistant, was none other than Elizabeth Taylor. She was, we later learned, en route to Morocco, where she would attend Malcolm Forbes's over-the-top 70th birthday party—to this day, one of the most lavish parties ever held.

Our analyst jobs didn't get us invited to that shindig, so we had to content ourselves with spying on Miss Liz, which was tons of fun in itself. She slept for several hours, her personal assistant helping her turn until she was perfectly comfortable and carefully arranging her blanket around her. It would be a lie to say she looked glamorous; without her makeup, she looked like just another middle-aged lady. Eventually, she woke up and headed for the bathroom. Ed, ever the in-your-face New Yorker, decided he wanted to get up close and personal, so he followed her. She eventually came back, and I watched

through the curtains as her assistant applied layer after layer of makeup to get her ready for the press at JFK. Let's just say that I was glad to be a man.

Suddenly, Ed entered our "suite" with an enormous grin on his face. "So what happened?" I asked. "Did you talk to her? Did she realize what a big swinging dick you are, that your opinion moves stocks, like, daily?"

"No, I didn't talk to her," Ed said, cracking up, "but I did sit on the same toilet seat!" I think he was sincerely thrilled. After all, how many people can say they sat on a can heated by Elizabeth Taylor's tush? Ahhh, Wall Street. I was beginning to like it here.

I LIKED IT A LITTLE LESS, however, when I actually had to sit down and write my first report. Believe it or not, my first report as a Wall Street equity research analyst took nine months to write. And the funny thing was that no one thought that there was anything outrageous about that. At the time, analysts were expected to spend a lot of time thinking and reasoning, and the firm was totally supportive. No one saw analysts as a potential source of income, so if it took nine months to write a report, well, so be it.

The harder I worked, the more my nerves got the better of me. My insecurities kicked in once again. "This is the Ivy League, not SUNY Albany, where I went to college, and Morgan Stanley is paying me all this money," I fretted every time I found myself at my computer at 3:00 AM. "I'd better blow them away or else. I'd better know every single detail of every line in that report cold," I warned myself.

My response to insecurity was to work harder. So I worked my tail off at the office, came home to Scarsdale, locked myself up in my attic office, and worked some more. Sometimes, Paula would bring me dinner upstairs, which I really appreciated, because I wouldn't have had a chance to see her—or to eat—otherwise. I tried to learn every facet of the telecom industry, every twist, every angle. The pressure, however, was coming from me and only me. Ed was calm, Morgan Stanley was calm, and everyone else seemed to have faith that I could actually do this job.

Finally, in early April, exactly nine months after I had started at Morgan Stanley, I screwed up my courage and handed a 90-page draft to Ed and Peter Dale, the head of research. I braced myself for the

worst: “You’ve worked on this for nine whole months and this is all you’ve got to show for it? What the hell have we been paying you for?” I imagined them exclaiming. Much to my surprise, both Ed and Peter liked the report, but each suggested many specific changes. An editor colleague, Fred Miller, helped me with a lot of rewriting and came up with a catchy title that I could never have imagined myself: “Max Headroom,” which was taken from a TV science fiction series that was big at the time.

In “Max Headroom,” I argued that serious competition was coming to the Baby Bells from new local phone companies. Even worse, their earnings would be held down by regulatory rules that provided limited “headroom.” The Bells, in my view, were going to have a tough time growing earnings as fast as others thought. I rated four of the seven Baby Bells as Holds, which meant that I thought these stocks were not going up much; they were stuck where they were.

Every brokerage firm and investment bank had a different rating system for its stocks, but overall they were quite similar: Either a three-, four-, or five-point system, with the top rating called Buy or Strong Buy, the middle rating called Hold or Neutral, and the worst rating of all usually called Sell. In the five-point systems, there were two other categories: Outperform or Accumulate, which usually meant the analyst thought the stock would rise at a moderate level, by say, 10–20 percent, over the next year; and Underperform or Reduce, which meant the analyst expected the stock price to fall by around the same amount.

At Morgan Stanley at this time, there were only three ratings: Buy, Sell, and Hold. Buys were stocks we thought would rise more than 20 percent over the next year, Sells should fall more than 20 percent, and Holds stood in between, expected to rise or fall somewhere between 0 percent and 20 percent during the same time period. I didn’t see much upside for the majority of the Bells, so Hold was the appropriate rating. In the eyes of investors, I learned, this was considered a negative call, a group of stocks not worth investing in. That’s because the objective of a professional money manager is to do better than, or outperform, the broad stock-market indices such as the S&P 500 Index or the NASDAQ. So a stock that wouldn’t make that happen was not a stock most professionals wanted to own.

Though I didn’t realize it for a while, my opinion was pretty much the opposite of the one presented by Jack Grubman, who, five months earlier, in December 1989, had written a bullish report strongly recommending the Baby Bells. He argued that they would benefit from

a string of high-tech new features and services, particularly video services. It was the beginning of an intense rivalry that would last more than a decade.

NOW THE REAL FUN was about to begin. The report went to Morgan Stanley's legal compliance team for review, to make sure that I wasn't disclosing—knowingly or not—any nonpublic information that our bankers, or anyone at the firm, might have become privy to. For example, if I had unwittingly discussed a potential merger that was already in process, all references to it would be omitted from the report. Even worse, the entire report might be scrapped if the lawyers did not want anyone, me included, to get the slightest hint of the pending, confidential deal. Fortunately, "Max Headroom" cleared those hurdles, and now it was time for my debut. I would present my report at Morgan Stanley's institutional sales meeting on the afternoon of May 9, 1990, and officially take over coverage of what was called the "wireline" telecom sector from Ed.

All of Morgan Stanley's top salespeople would attend the meeting, some by phone, most in person. Since Morgan Stanley didn't yet have a retail brokerage arm that sold stocks directly to regular folks, these salespeople called primarily on big institutional investors and extremely wealthy individuals. They would listen to my presentation, and then, assuming they bought my argument, take it out to the Street. If the Street paid attention, we'd see these stocks fall, since I was presenting a pretty unenthusiastic opinion. Was I actually going to move the stock market?

Two days before the report was published, I was told to give the banker who covered the Baby Bells a copy of the report as a courtesy. I didn't know what to expect, especially considering the fact that my opinions were not going to endear me to the Baby Bells—or to Bob Murray, the banker. But Bob couldn't have been more professional. He read the report, and put it back on my chair the next day. His only comment? "BellSouth is one word, not two." No interference, no "helpful" suggestions, no nothing. That was the way I first experienced life as a research analyst at an investment bank.

Since my report was now 70 pages long, and I doubted the salespeople would read the whole thing (or any of it), I wrote and distributed a two-page crib sheet outlining my argument. That afternoon, I waited nervously as other, more experienced analysts

made their presentations, describing softness in demand for deodorant and an uptick in orders for personal computers. Finally, they turned the microphone over to me, and for 10 or 12 minutes, I did my best to convince Morgan Stanley's salespeople that my analysis of the Baby Bells was worth passing on to their buy-side clients.

I knew this material inside and out. But, as I started to speak to Morgan Stanley's institutional sales force that afternoon, I feared that I was going to slip up somehow, or that I'd made the wrong call on the stocks. In this job, I'd get my report card quickly, when the next day's stock market would make clear whether people thought I was a bozo or a brainiac. I made it through my presentation, but during the Q&A that followed, Bill McElroy, an astute salesman, stopped me cold with the most innocent of questions.

"Are you saying that investors should be underweighted or overweighted in the sector?"

Whaaaa? I froze. I was not prepared for such a basic but reasonable question, focused as I was on all the obscure details. What he was asking was whether one should put a higher percentage of one's assets in telecom stocks than they represented as a percentage of the overall market. Basically, he wanted to know if I thought the Baby Bell stocks would perform better than the market. I glanced over at Ed, sitting in the fifth row center, who was calmly mouthing "under, under."

"Underweight," I blurted, trying to sound confident.

Once finished, I raced back to the office for the next phase of releasing a report. I called as many buy-side clients as I could to further explain my position to them and to make that "personal contact" I was learning was so very important.

After ten months of sweating bullets, the whole thing was something of an anticlimax. The salespeople were moderately but not overly impressed. I was just another analyst making just another report. And the stocks themselves? They didn't budge. It was a humbling experience.

I eventually realized three things: first, I was covering slow-moving stocks that didn't fluctuate a lot; second, I was brand-new and no one was going to invest money on my recommendations yet; and third, I had presented an entirely well-reasoned but entirely unsexy

report. It didn't have any juice, any pop, any emotion, any insider-type info. Other than "Max Headroom," its title, it didn't even have any catchy phrases. Those were the calls they loved, the calls that moved markets.

Ed consoled me. "Your job is not to move stocks the first day," he said. "It is to get yourself recognized as someone who knows the industry. Your job is to get Fidelity and Capital Research and Alliance Capital Management to call you before they decide to buy or sell telecom stocks." These were the huge mutual funds that were Morgan Stanley's biggest trading clients, as well as the biggest owners of stocks and bonds in the world.

I knew Ed was right, but for years, I couldn't help but stare hopefully at the screen the morning after I announced a change in ratings or put out a new report. Sometimes, particularly after I became known on the Street, my reports moved stocks immediately. But if I had interpreted an event or news report as bearish and Bell Atlantic or PacTel closed *up* 50 or 25 cents, I took it personally. Why was someone at Putnam or Fidelity buying when I'd laid out such a well-reasoned argument against doing so? Eventually, I calmed down, but it always struck me that, unlike many people in the corporate world, investors and their advisers got graded every day. If I missed some news or made a bad call, I'd hear about it immediately, first from the trading prices of the stocks and then from an unhappy money manager who'd followed my advice or a Morgan Stanley salesman who'd pitched it hard.

The month after my piece came out, Jack Grubman wrote a quarterly update report, mentioning that those who were looking at regulatory "headroom" were looking at the wrong issue. He meant me. It was a personal shot, yet I got some satisfaction from the fact that I had at least gotten some attention and free advertising from a competitor who had confidently predicted my failure.

"We Do Not Make Negative or Controversial Comments About Our Clients."

Over time, I acclimated myself to this whole new world. Yes, I had to sell myself, and surprisingly, I didn't dislike it as much as I'd anticipated. But for the most part, I was free to pursue research, to write my honest opinion without the interference of bankers or anyone else, and to do the job the way I'd envisioned it.

It was a rare period in Wall Street history. People were on their best behavior, in part because of the spate of insider-trading cases that had rocked the world just a few years earlier. Ivan Boesky had recently been convicted of insider trading, using inside information to profit on deals that hadn't yet been announced. That inside information had been leaked to Boesky by some investment bankers. In this context, few people wanted to push the envelope. And the market was puttering along as well. The operative word of the day was *steady*. And steady was a concept I felt very comfortable with.

Although the mere mention of insider trading was enough to strike fear into any Wall Streeter's heart at the time, no one got too up in arms over the interaction between research analysts employed by investment banks and the banking business itself. In part, that was because analysts exist thanks to the banking business; they don't generate enough profit to support themselves. In effect, analysts are loss leaders for banks. Their work is funded by the fees brought in by bankers and the commissions brought in by salespeople and brokers.

That's why there were and are strict rules governing the interaction between the two. At Morgan Stanley, a written policy given to me upon my arrival at the firm officially and emphatically declared the independence of the research division from pressures by the investment bankers.

"Morgan Stanley's research is totally separate from the investment banking of [*sic*] and merger and acquisition activities of the Firm," it read. "Rigid rules ensure the separation of association and information. A basic tenet of our philosophy is that research must have integrity and therefore requires absolute and impartial freedom of judgment."[2]

In practice, however, it was slowly becoming a different story. Although I had not experienced any overt pressures, some sordid stuff was beginning to swirl around the firm.

One of these was the Clay Rohrbach memo. Clayton J. Rohrbach, III, was the head of stock capital markets, in other words, a big-shot banker. The way I remember the story of Clay's memo, a young guy named Sandy Cohen was Morgan Stanley's utility analyst at the time. Like me, Sandy had been mentored by Ed Greenberg and had developed a habit of speaking his mind, even if it angered the companies he covered. He had developed a special methodology for rating his companies, a very technical one that spit a lot of components into a formula and came out with an opinion.

One of the criteria he plugged into his model was the quality of management. Some of the people who ran companies were true dolts, while others were real strategic thinkers. Anyway, Sandy ranked one of his utilities low in the management department, and Clay, as the keeper of the flame, or that "special relationship" with the company, apparently got an earful about it. From Clay's perspective, research must have seemed like something of a waste of time. It didn't make any money—and was, in part, paid for by the fees generated by bankers like him. So wasn't it logical that an analyst, whose salary and bonus inevitably came from the money earned on deals, shouldn't do anything that could jeopardize that deal flow? Ticked off by Sandy's conclusions, Clay wrote a memo in September 1990 that shocked all of us on the 20th floor, which was where Morgan Stanley's research analysts worked.

"As we are all too aware," it said, "there have been too many instances where our Research Analysts have been the source of negative comments about clients of the Firm…. Our objective is to have a zero failure rate on this subject and to adopt a policy, fully understood by the entire Firm, including the Research Department, that *we do not make negative or controversial comments about our clients as a matter of sound business practice."*[3]

This, of course, was absurd. Did Clay think we should rave about every stock in the entire stock market, even if it was a dog? Although Clay's memo was later portrayed as a one-off outburst, he clearly felt strongly about the issue. Earlier that year, Clay had written a draft memo proposing that research-analyst pay be determined partly by how much they had helped bankers win deals, with analysts getting an A, B, or C grade depending on how "instrumental" they were in the firm's winning of a transaction.[4]

What Clay was trying to do, in effect, was make the analysts earn their keep. He, and some others, were trying to change the analyst's job from giving good advice to investors to helping bankers do deals. For me, it was the first example of the crossing of that supposedly sacred line between banking and research.

What Clay was experiencing was the end of the genteel old world of banking, in which belonging to the same country club and living in the same town was as much of a draw for a corporate executive choosing a banker as the actual services the bank was offering. As banking became more competitive, these relationships weren't enough anymore. Banks needed to offer something extra, some special sauce. As time went on, that special sauce would often involve bullish

research.

I guess I was lucky, both because I had an old-school banker in Bob Murray, who didn't interfere with my opinions, and because the telecom sector did virtually no deals at that point, so there was no reason to meddle and no way to assess my level of "cooperation." At the same time that my colleagues were murmuring that they were starting to get heat for their opinions, I had a Sell rating on one stock, Ameritech, and Holds on most of the Baby Bells, and never heard a peep about it from anyone.

In any event, someone eventually leaked Clay's memo to *The Wall Street Journal,* which ran a front-page story on the shenanigans in July of 1992. It was a huge embarrassment for Morgan Stanley—the most highbrow firm now essentially being caught red-handed trying to influence research. As far as I know, Clay was never disciplined. He went on to have a long career as a senior banker at several major houses. The whole episode is a reminder that the scandals of the late 1990s, as shocking as they were, had plenty of precedent and plenty of warning.

I heard these things but reacted to them a little bit like an ostrich. No one was bothering me, so it didn't seem like something to get worked up about. In my world, Morgan Stanley seemed pure. I didn't see anyone daring to put the squeeze on Ed, my mentor. He managed to have strong opinions—positive and negative—without being pressured by anyone, not bankers, not management. As his protégé, I felt insulated and protected.

By now, Ed had initiated coverage of the cellular, or mobile, phone industry with negative views. He predicted much lower prices resulting from increased competition, as the federal government was awarding many new licenses. He assigned Sell ratings to five of the seven cellular companies he covered and Hold to the remaining two. Several of the companies were even Morgan Stanley investment-banking clients. Yet no one seemed to raise an eyebrow. Ed's Sell ratings made sense in the context both of his detailed analysis and of the overall stock market. Indeed, the major stock market indices had been trading sluggishly for quite a while and there was nothing to suggest that was going to change anytime soon.

Ed's report was outstanding, perhaps the best I had ever seen. It was deep in its analysis, thorough in its consideration of the numerous variables that would drive the future of the cellular industry, and prescient in its prediction that the federal government would allow

many more competitors.

Yet contrary to Ed's predictions, several of the cellular stocks took off, driven by a massive consolidation wave throughout the industry. Several large companies, including AT&T and the Baby Bells, went on acquisition binges, paying hefty prices for the stocks Ed disparaged in order to fill in geographic holes in their cellular coverage. And technological improvements and lower prices meant customers began to use cell phones more than anyone could have imagined.

More significant than all of these factors, however, was the suddenly turbocharged bull market. In the 12 months after Ed's bearish report, the Dow Industrials rose 17 percent and the NASDAQ index, where most of the cell phone stocks traded, rose over 20 percent. Once that bull began to rage, bearish calls like Ed's were ruthlessly stampeded: within four years of his call, for example, the Dow had risen almost 50 percent and the NASDAQ by 67 percent. Ed was lucky. He was a top-rated analyst, had a stellar reputation, and was about to move to banking anyway. Many other bears, however, found themselves overrun by the roaring bull market of the 1990s, and were never heard from again.

There were two very simple lessons to be learned from Ed's experience with the cellular stocks. The first was to never get on the wrong side of a major bull or, for that matter, a major bear market. Either one can flatten you, no matter how astute your insights and sophisticated your analysis.

The second lesson was that Sell ratings offer little payoff to a Wall Street analyst. This is because, for the most part, institutional investors are paid to pick stocks that go up. They need to outperform the overall stock market by enough to compensate for the risks, fees, and trading costs they incur. As a result, stocks that perform in line with the market are of no interest to these money managers.

If a stock falls or performs in line with the market, the Wall Street analyst who rated that stock Hold or Neutral looks almost as good to his clients as the one who rated it Sell. As a result, analysts didn't have much incentive to go out on a limb with a much riskier Sell rating, even before the banking pressures emerged.

At that time, I didn't fully understand any of this. And I soon learned that Ed had been protecting me from other matters as well. One morning in October of 1991, I was toiling away on a very long report on a local phone company called Centel. I had spent about two

months working feverishly on it, and was just about finished, when I looked up at my computer screen to see a news flash: “Centel Board to Put Company up for Sale.” Even more surprising to me was the fact that the board had hired none other than Morgan Stanley to be the banker in charge of this auction. How could I not have known?

Ed walked in that morning and said, “I have to apologize to you, Dan. But I couldn’t tell you.” It turned out that Ed had known all about the pending announcement for weeks and had been asked to give his opinion to the bankers on whether Centel should sell itself to a larger company or go it alone. Ed’s expertise and knowledge of the industry was eagerly sought by Morgan Stanley bankers and telecom executives. Because he had been brought “over the Wall” to the banking side, he said, using a cryptic—and compelling—term I had never heard before, he couldn’t tell anyone, not even me, without possibly running afoul of insider-trading rules. If he told his wife, his colleague, or his plumber, he’d be improperly sharing proprietary inside information with other people.

The wall that Ed was referring to going “over” was something commonly known on the Street as the Chinese Wall. Meant to be as big and impenetrable as the Great Wall of China, the Wall was a metaphor for keeping information about pending deals or transactions in the hands of the bankers who helped put those deals together. If that information leaked out to the rest of an investment bank—anyone from traders to research analysts to even the cafeteria workers—someone could use that information to buy or sell the stocks involved, making an unfair and illegal profit. This was what Ivan Boesky and bankers from Drexel Burnham Lambert and Kidder Peabody had been convicted of just a few years before. I knew all about the Chinese Wall, of course, but I had had no idea until that moment that there were exceptions to this rule for analysts. Apparently bankers didn’t have all the answers when it came to deals. In some cases, analysts could provide some added perspective that might never have occurred to the bankers and company executives.

My first reaction was frustration. I had just spent two months learning everything there was to know about Centel, and my own bank couldn’t even tell me it was being sold. This deal also meant that I’d now be “restricted” from publishing my report while Morgan Stanley’s bankers handled the auction, which could take several months. And if the bankers did manage to sell the company, the report would become irrelevant anyhow, so I’d essentially wasted two months of my life.

But Ed had done the right thing by keeping quiet, I soon realized. This was the way the game was played, and if I lost a few weeks but managed to avoid the temptation of insider information, well, that was just fine by me. At the same time, the more I thought about this over-the-Wall stuff, the more intrigued I became. I was fascinated—and wondered if my views would ever be respected enough to be asked to come over the Wall one day.

2. AROUND THE WORLD IN SEVEN DAYS (OR LESS)

1992–1993

Most people would have seen a 30 percent increase in pay as a pretty fantastic raise. I would have, too, if I hadn't had that sizzling offer burning a hole in my pants pocket. I had no intention of staying at this point, but this game had rules and I had to play it out.

Climbing Over the Wall

THIS MYSTERIOUS CONCEPT of going over the Wall quickly receded into the back of my mind. But one day in November 1992, it suddenly reappeared. Ed strode into my office, closed the door, and said "Get up. We're going upstairs to a meeting of the Corporate Finance Executive Committee in the Morgan Stanley boardroom. There's a deal that Jeff [Williams, Morgan Stanley's head of telecom banking] and Paul [Taubman, its head of telecom and media mergers and acquisitions] want us to react to."

I exhaled with irritation. Yeah, this over-the-Wall stuff had sounded intriguing at the time, but now that intrigue had been buried under a pile of paperwork. I had almost a dozen phone calls left to return that afternoon and he wanted me to go to some banker meeting?

"Huh? How long will this take?" I griped. "Where the hell is the boardroom and what the hell am I going to do in there?"

"I'll do most of the talking," said Ed. "Just come with me."

Still muttering, I hopped on the elevator and walked into the boardroom, where I felt an instant jolt of electricity. Someone handed me a three-page outline, and I quickly scanned it. AT&T was about to purchase a big piece of McCaw Cellular, the country's largest independent cell phone company. McCaw had received a lot of attention in recent months when it won a bidding war against

BellSouth for Lin Broadcasting's cellular assets. In my world, it was a seismic event, as if IBM bought a portion of Apple. No wonder these guys, some of the top bankers in the firm, looked as if they had ants crawling around inside their Brooks Brothers pants.

"Here's the deal," said one banker. "Tomorrow morning, AT&T is going to announce that it's buying 33 percent of McCaw Cellular. AT&T is paying $42 a share for 47 million new shares of McCaw, a 57 percent premium over its trading price, and $49 per share for 38.5 million shares held by British Telecom. That makes the transaction worth about $3.7 billion. Ed and Dan, what do you think of this move?"

Whoa! Suddenly we were on the spot. Because Morgan Stanley had been AT&T's lead banker for years and years and AT&T seemed to always have a deal pending, I had not been allowed to write reports on the company or rate its shares. According to federal securities regulations at the time, anything I wrote could be perceived as putting Morgan Stanley's interests ahead of investors. That was because Morgan Stanley had a huge incentive to plug AT&T's stock, since it received fees whenever a deal involving AT&T went through. Rating AT&T a Buy could be considered an attempt to convince shareholders to vote for the deal, which of course would benefit AT&T and, by extension, Morgan Stanley. So Morgan Stanley's lawyers required Ed and me to stay mute.

This silence had become something of a problem for me, since not only was AT&T—the original blue-haired grandma stock—in the news virtually every day but its stock was held by just about every investor on the planet, and I wasn't able to make a call or advise my clients on what to do with it. (The SEC would later choose to not enforce the rule requiring analysts to recuse themselves, facilitating a huge wave of banker-research conflicts of interest.) I didn't feel particularly good about AT&T—influenced by my MCI days, I thought of the company as a huge, lumbering oaf that was going to lose its shirt to all of the new rivals out there—but I did intuitively like this deal. I wasn't sure what to say.

Fortunately, Ed jumped in first. "I think it's a brilliant deal," he said. "McCaw is the largest independent cellular company in the U.S., cellular is a very rapidly growing business, and the ability to jointly provide long distance and cellular services ought to give AT&T an edge over MCI and Sprint [neither of which offered cellular]." Ed did point out that AT&T's earnings would drop as a result of the acquisition, which would probably cause the stock to fall a bit

initially, but said that overall the impact on future growth would be very positive.

Then it was my turn. “Anything to add to that, Dan?”

“What strikes me,” I said, “is that AT&T is declaring war on the Baby Bells. It’s acquiring a technology that could be used someday to connect directly to customers, potentially displacing the Baby Bells’ copper wires.” I said I thought most large investors would think it was good news for AT&T and bad news for the Baby Bells.

That was all the bankers needed to hear. I wondered why Ed and I were there; would they have scrapped the deal if we’d thought it was a terrible idea? I doubt it, given the buckets of banking fees they would earn if the deal went through. But the bank had a committee that required all parts of the organization to be consulted. The guy running the meeting asked if anyone around the table had any questions or concerns about Morgan Stanley’s involvement in this transaction. Was there anything that the press, other investment bankers, or my clients, the institutional money managers, might criticize us for? Was there anything in the deal’s structure or valuation that might harm our venerable investment banking reputation? No one said anything, so the committee voted to approve the deal.

We all got up to leave. And I found myself in possession of information that was going to make and lose many people billions of dollars in less than 24 hours. Owners of AT&T shares would likely lose a bit, as would owners of Baby Bell shares. Investors in other cellular companies would benefit, since the possibility rose of takeovers of other independent cellular companies. And obviously McCaw shares would surge when the news hit the next morning.

As I walked out of the room, I felt confused and a bit giddy. No one had told me why I’d been called over the Wall this time but not other times, or how I should handle the confidential information swirling around in my brain. None of the seemingly important managing directors in the room had said hello or introduced themselves. Although they had asked for our reaction, it wasn’t clear they had listened. We analysts still didn’t command a whole lot of respect.

So now here I was, with almost a dozen clients to call back and another hour of trading to go in the market. I felt like a newly minted secret agent who now had to return to my regular life. The telecom analyst at Fidelity had called earlier in the day. So had Tim Armour,

the telecom analyst at Capital Group, and several other well-connected buy-siders. I had to call them back. I had already learned that prompt responses to clients were a must if you wanted to get their votes on that survey of institutional investors. Yet now I was in possession of information that could make my clients—and myself—rich, if I used or shared any of it.

Even though no one told me what to do, I knew that I couldn't breathe a word about the announcement. If I said anything, I'd be passing on insider information and perhaps violating federal criminal laws. Luckily, I didn't cover AT&T, given its perpetual "restricted" status, and I didn't cover McCaw either. So it was unlikely that clients would be asking me about either one. But I still had to call them back. What if, somehow, rumors of the deal started to build? I'd be hit with a barrage of calls from money managers and buy-side analysts, as it was no secret that Morgan Stanley had done banking for both firms. They'd ask what I thought of the amount AT&T might be paying and how the shares of each would respond. I had no idea how to respond to these kinds of queries. I'd lived through the insider trading scandals of the late 1980s and remembered how those ended: with those bankers in handcuffs paraded in front of a band of photographers jostling each other for the best shot. I instinctively knew that if anyone asked me about a deal involving AT&T or McCaw, I'd have to play dumb. I got lucky; no one did. But my job had suddenly gotten a lot more complicated.

"You're the Only One."

As the 1990s went on, the planets of the bankers and the analysts slowly began to orbit more closely around each other. While there had always been interactions, now the bankers, long the alpha dogs, were beginning to realize that research could wag its tail too. If used in the right way, those nerds in the back room might help them make big money.

My first strategy session with Morgan Stanley's bankers happened long before my first over-the-Wall experience. Late in July of 1990, a group of bankers and analysts had gathered in Vermont for a few days of brainstorming at the bucolic Woodstock Inn. It was kind of funny to see all these hardass New Yorkers out of their element: most of them looked as if they'd hit the deck if a deer trotted out of the woods.

On the first day, we got together with the bankers who covered telecom. Ed and I sat on one side of the conference table, while the bankers, facing us like opponents in a chess game, sat on the other.

Among them were Jeff Williams and Paul Taubman, Morgan Stanley's main telecom bankers. Also sitting across from us was a man who worked in Morgan Stanley's San Francisco office and was responsible for relationships with technology companies. His name was Frank Quattrone.

The mood was congenial—no one was bellyaching over our investment ratings—but still, the bankers needed our help ginning up deals that made sense for their corporate clients. After all, they got paid a percentage of the total value of the deal. We discussed each telecom company.

"Any holes in BellSouth's portfolio?" the banker responsible for BellSouth asked, hopefully. "Do they need to make an acquisition? Will they need to sell stock or to refinance any soon-maturing bonds?"

Ed and I did our best to answer all their queries. I saw nothing wrong with this—after all, many of these companies were certainly going to do deals as the sector consolidated—and we weren't suggesting anything we didn't tell our investor clients. We were there for just a day, and then left so the bankers could go back to their side of the Chinese Wall, discussing secret deals that were already in progress.

Shortly after the retreat, Morgan Stanley split up its telecom and technology banking departments, in large part because of Frank Quattrone. Frank, a dapper, low-key guy from Philly with a Tom Selleck mustache, had joined Morgan Stanley in 1977 and quickly built up a reputation as a banking stud. Among his early initial public offering (IPO) successes were Cisco Systems and Silicon Graphics Inc. One of the first to lock in on the growing number of small technology companies using the public market to raise money, Frank was well-respected at Morgan Stanley, largely because he was bringing in so much in the way of fees.

But he was aware, even then, of the benefit of a positive analyst report. According to *The Wall Street Journal,* after handling an IPO for a company called Mips Computer Systems Inc., Frank allegedly pushed an analyst, Rick Ruvkun, to put out a positive report on the company in 1990. Ruvkun wrote a report, but rated the stock Hold, not Buy, showing that there were limits to Frank's clout.[1] Frank denied the account in the *Journal.*

In 1986, Frank moved to Silicon Valley to start Morgan Stanley's California-based banking group devoted to technology. It was seen as

a huge affront to Morgan Stanley telecom banker Jeff Williams, who believed he was in charge of both tech and telecom. But Frank was onto something. Where other people saw obscure technology and engineers who forgot to shower, Frank saw possibilities. He was fast becoming one of the most powerful forces within Morgan Stanley and in Silicon Valley as well.

BY THE BEGINNING OF 1993, after three and a half years on the job, life at Morgan was finally becoming comfortable. Coming to the Street had absolutely been the right move for me. I felt more confident about my performance. I occasionally left my attic on the weekends, and I'd started to get some attention on the Street for my calls. I even found myself enjoying some of the social side of the business—not the schmoozing per se, but the discussions with my clients over the future of this new industry.

The period was a real turning point for telecom, a time in which everything was possible and no one company had the obvious edge. Everything was open to debate, and debate we did, hour after hour, trying to decide the investment implications of this new world. Telecom had seemed like something of a backwater at first, but it was gaining momentum, thanks to the regulatory reforms that were creating competition and the increasing popularity of cell phones. I was thankful that I wasn't in some dead or dying sector like steel or chemicals.

One blustery day in early January, the phone in my office rang. My assistant put through the call, which I thought at first came from a client. "Dan, we hear you're doing great work," Les Carter barked. Carter ran recruiting firm Carter Stone, one of the many firms recruiting Wall Street analysts.

"I'm sure you're happy at Morgan," Les said, "but Merrill Lynch is really interested in you. You're the only one." Les invited me to breakfast, and I accepted, more out of curiosity than anything. I'm the *only one?* The guy knew how to make a man feel good. Even if it was a bald-faced lie, which it was, I liked what I heard.

I hadn't been looking for a change, but the call came at a good time. I had been ranked as a runner-up in the *Institutional Investor* survey in October 1991, which meant I was in the second tier, below the top three analysts, and then moved up to third place in the most recent poll, which had been published in October 1992. Robert Morris

of Goldman Sachs was number one in both of those years, as he had been for the past eight years, and Jack Grubman was number two in both surveys.

Normally, this would have meant a big bump in my pay, but 1990 had been a terrible year for the investment banking business, with lots of analysts getting canned. I was cheap compared to the other analysts, so there wouldn't have been much point in firing me even if I hadn't made the *I.I.* list. Even so, in 1991, Morgan had doubled my compensation to $350,000, and my ego was getting healthier by the day. I wondered if it was time to break free from Ed.

But Merrill? If Morgan Stanley was the aristocrat of the Street, Merrill was the arriviste, at least when it came to banking. Morgan Stanley had no retail arm, whereas Merrill's bread was buttered by the small investor, served by over 10,000 brokers in 500 offices throughout the world. Morgan Stanley stuck to its fee structure and prided itself on being choosy, while Merrill—eager to convert its highly successful retail brokerage into a world-class investment bank—offered aggressive discounts to win banking business. Cool and snooty versus aggressive and loud; pink pants versus pinky rings; country club versus Paddy's Pub; the two firms couldn't have been more different.

After a pleasant breakfast with Les, he told me that Merrill's head of domestic research, Andy Melnick, would like to meet me on January 20. All the banks had secret clubs or restaurants where they did their wooing. Andy liked to do his recruiting at Fraunces Tavern, a colonial-style eighteenth-century restaurant near Wall Street where George Washington made his farewell address to his officers in 1783. It made perfect sense; Merrill, the firm with the nouveau reputation, tried to buy itself gravitas with meetings at a place like this. I guess they had a deal with the management, because we met for breakfast, even though Fraunces Tavern didn't serve breakfast—not to regular folks, anyhow.

For us, they did serve breakfast, but apparently we didn't merit heat. I could see my breath as I chatted with Andy and Jack Lavery, Merrill's head of global research and Andy's boss. There was one waiter, clearly brought on for these special meetings, who must have known more about Merrill's pay structure than anyone else in the world. I should have hired him as a consultant when I was negotiating my salary.

"We are in the process of building the number one research

department in the world," Andy said, "and you are critical to our success. Our firm is completely focused on telecom, and to get a piece of the coming privatization wave, we must have the best possible U.S. telecom analyst."

Jack and Andy mentioned that they had thoroughly checked me out with buy-siders and were convinced that I was moving up in the *I.I.* rankings, which they seemed to be very, very concerned about. They also talked up the power of their trading operation, which meant that an analyst's calls would have a lot more impact than they would elsewhere.

I was impressed, and asked how they would feel about bringing over my associate, Rick Klugman. Rick was a young, eager, loyal guy whose shirttail was invariably hanging out of his pants. He was very bright and worked his tail off, and I hoped to get him a big raise. It didn't seem to be a problem. Andy presented himself as the kind of guy who would mentor young analysts but otherwise stay out of the way. I found his "aw shucks" approach appealing, even if I didn't totally buy it.

What I didn't realize at the time was that Merrill was desperate to recruit an *I.I.*-rated analyst because the British government was about to choose several firms to lead the third and final phase of the $22.9 billion privatization of British Telecom, and had indicated that no bank without an *I.I.*-ranked analyst would be considered.

A few days later, I met Dan Tully, Merrill's CEO and chairman, in his office, which was decorated in standard-issue Wall Street: lots of golf mementos and pictures of Tully with various presidents and CEOs. A jovial, smart, and charming guy, Tully and I hit it off right away. I was flattered that he was making time for me, which was of course the point. With his gift of gab and Irish charm, it was easy to see why he'd been so successful. He quickly homed in on my favorite topics—skiing and family—and we spent the entire time talking about our kids. He called me "Danny Boy," to break the ice. Later, whenever we ran into each other, we'd race to be the first to call the other "Danny Boy!" I knew I was a bit insolent, but Tully was more the common man than any other executive I had ever met.

Having met the approval of Merrill's CEO, I then met, on February 2, 1993, with Tom Davis, its head of investment banking, and Jerry Kenney, who was Jack Lavery's and Andy's boss and Merrill's chief strategist. Again, the meeting was treated with as much secrecy as Nixon's trip to China. It took place at the Essex House, an upper-crusty

hotel on Central Park South. My instructions, which had a satisfying whiff of James Bond about them, were to ask at the front desk for the key to room 2112 or whatever it was. Merrill rented a suite there, and when I walked in the room, the two executives were already waiting for me.

I had had to sneak out of the office, telling Rick Klugman that I was going home for my luggage, as I was bound for Amsterdam that evening. Because we worked so closely together and talked so frequently, even when I was traveling, it was a real challenge to come up with a valid excuse for going AWOL. I had enjoyed the process so far, but I wasn't at all sure I wanted to make the move. Things were going really well at Morgan Stanley, and the pay, of course, was dramatically higher than I could have imagined making just a few years earlier. But Merrill understood something that Morgan Stanley didn't. The countries of the world, from Indonesia to Britain, were now in the process of *privatizing,* that is selling to the public, scores of nationally owned phone companies. If one bank could become known as the go-to place for these deals, there were literally billions of dollars to be raised and hundreds of millions in banking fees to be made. Morgan Stanley took privatization seriously on a case-by-case basis, but once I heard the Merrill guys' pitch, I realized that they were a lot more ambitious.

"Look," Jerry said, "we need to have the world's premier telecom research, because fifteen countries or more are going to privatize their telecom companies over the next five years. We want you to be our global telecom leader, and we want you to be our main U.S. telecom analyst as well."

It seemed as if Merrill was offering me the chance to build my own team, see the world (first class, of course), and participate in the economic restructuring of the post–Cold War era. It had been four years since the fall of the Berlin Wall, and capitalism was now the only game in town. As governments from Europe to Asia to Latin America privatized their largest companies, they could raise a huge amount of cash and inject capitalism into a large part of their economies. Telephone companies were perfect for privatization: they sold a necessity, demand was growing steadily in Europe and very rapidly in the developing world, and new services such as cellular were blossoming.

Then there was the money part. If Merrill was right about the market, the privatization fees would be so huge that the salary and bonus of an analyst was basically irrelevant, a point no one hesitated

to make. The headhunter had told me that the job would pay in the high six figures, and I had in my head a sense that that probably meant about $800,000. It was an absurd amount of money, especially because I would be doing something I enjoyed so much.

"Hi, I'm John Mack…"

All of this happened just before bonus checks were handed out on Wall Street. Bonus time on the Street was the most eagerly anticipated, tension-filled month of the year. The rumors began early and spread faster than the usual sex or political gossip. And, once you found out your "number," it was time to move.

The end of February on Wall Street was the equivalent of summer in the Serengeti Plain, with the annual mass migration not of zebras and springboks, but of bankers, brokers, and analysts to their competitors who were willing to pay more. It was a time to plop new butts in all the suddenly empty chairs, disconnect and reconnect phone lines, empty and fill cabinets, and order new corporate credit cards. It was perfectly normal to walk in one morning and discover that the chemicals analyst you sat next to had evaporated into thin air. One day he was your neighbor; the next day he and his crew had decamped to Goldman, where they were already at work launching coverage. It wasn't worth it to make great office buddies, because they didn't last.

So the Tom and Jerry Show continued, climaxing with Jerry Kenney, the strategist and designated closer, making an offer that made my toes curl. "This is going to be your platform," he said, mustering up all of the salesmanship he normally used on banking clients. "Merrill's sales force will help you move to number one [on *I.I.*]." And, oh yes…how would you feel about $1.2 million per year, guaranteed for three years?

"Holy. Fucking. Shit." I almost blurted aloud. Four years earlier, I was a cog in MCI's wheel, making $70,000 a year. Now I would earn in one year what I once yearned for in a lifetime. And they also were offering me the chance to head the global research team leading the privatization charge and advising governments around the world. How could this be?

What I didn't know at the time was that I hadn't been the first choice for the job. Merrill had gone after a few better-known analysts, including Frank Governali of Credit Suisse First Boston (CSFB) and Joel Gross of Donaldson, Lufkin & Jenrette (DLJ), and had come up

empty. Merrill had offered them a lot less money to begin with—apparently not enough to convince them to leave their safer perches and try to build a new platform. Merrill had upped the ante with every succeeding offer.

Even though I probably would have taken the lower offers they made to Frank and Joel, I got the benefit of Merrill's panic. So I tried to paste on a poker face and told Tom and Jerry I'd let them know. I needed to go home to get my luggage (it wasn't a complete lie) and then on to JFK to catch that plane to Amsterdam. Jerry knew that. "Tell you what," he said, putting a cherry on top of the sundae, "after he drops me off at my apartment on Park Avenue, my driver will take you home to Scarsdale to get your stuff, and then to the airport."

After talking it over with Paula, it became clear that going to Merrill was a no-brainer. I was getting a promotion to managing director and a huge salary increase, and I would have a bigger staff and more dollars to pay them. Equally important, Merrill had far more investor clients—and potential *I.I.* voters—because it served not just the largest money-management institutions, as Morgan Stanley did, but also many smaller ones. But I still had to play the game.

On February 9, exhausted from the one-day trip to Amsterdam, I walked into the office of Jay Cushman, head of Morgan Stanley's domestic research, to get my bonus numbers. Jay and Jack Curley, the head of global research and Jay's boss, greeted me with huge smiles.

"Congrats, Dan," Jack said. "You had a great year and we're going to bump you up from $350,000 to $475,000. You're doing a great job, and this percentage increase is really good compared to the average for the division."

Most people would have seen a 30 percent increase as a pretty fantastic raise. I would have too, if I hadn't had that sizzling offer burning a hole in my pants pocket. I had no intention of staying at this point—I felt Merrill understood the importance of telecom in a way that Morgan didn't—but this game had rules and I had to play it out.

"To be honest," I said, "I'm quite disappointed." This was the script everyone knew to use when you were contemplating making a move. Jay was silent. Jack repeated his line, that the increase was much better than the department average and that it was a reflection of the great work I was doing.

Although I was leaving, I couldn't say anything to anyone until my bonus check cleared at the end of February. As soon as it did, I told Ed the whole story except for the amount Merrill was offering, which I didn't want to leak out. Ed told me my decision made a lot of sense, but asked for a day or so to see if there was anything he could do. I was going to miss Ed, but I knew that this was the right move and that we'd stay friends for years to come.

A day later, Jay came into my office and closed the door. "We've talked with the bankers," he said, "and the bankers really pay the bills. We want you to stay, and we're thinking that next year we can pay you $750,000." Clearly, this was a gangbusters offer in his eyes.

But then came the catch: "Of course, Dan, it's dependent on the telecom bankers making their budget for 1993…."

That was all I needed to hear: I had no idea what the bankers' budget was, or what their chances of reaching it were, and I certainly didn't want my pay tied to how much money the firm received from the companies that I was assigning stock ratings to!

That evening, I flew to Kansas City and St. Louis for meetings with analysts and portfolio managers at American Century, Waddell & Reed, and Boatman's Bancshares Inc. I called Andy Melnick at Merrill the next morning to tell him it was a go. After my meetings, I went to the airport and then spent much of the rest of the day grounded by a snowstorm, having Andy fax a contract to the airport's business center so I could review it and then forward it to my lawyer.

On March 1, I told Jay I had decided to take the Merrill offer. I'd already taken all my important reports home with me, because when you leave, you're outta there the second you give notice. Any files and professional material belong to Morgan, not you. There aren't any good-bye parties on the Street. It's just one big see-ya…and don't let the door hit you in the ass on the way out.

Hold on, Jay said. "Bob Greenhill [Morgan Stanley's president] wants to see you. Go to his office at 2:30 PM today." Well, okay then. So at 2:30 on the nose, I went upstairs to the president's office on the 32nd floor. I waited in his office for quite a while, until finally someone walked in. It wasn't Bob Greenhill at all.

"Hi, I'm John Mack," he said, shaking my hand. Mack headed Morgan Stanley's fixed income department. He was a North Carolinian of Lebanese descent whose father had been a wholesale grocer. Unlike

most of the big shots on the Street, Mack was deadly serious and not one for shooting the breeze. He got right to the point.

"Bob resigned today," he said. He apologized for being late and for the crazy circumstances of him standing in for Greenhill. Mack was very charged up, having just found out a few hours ago that he was being promoted to president of the firm. He had a bunch of crises on his hands already, such as how to hold on to all those Greenie loyalists who might be offered lucrative deals by Smith Barney, where Greenhill had gone. He did focus on me, though, for about 10 minutes.

"I don't know you, Dan," he drawled, "but I've been told that you're a very valued employee of the research department and telecom is very, very important to this firm. We would like you to stay. Have we mistreated you?"

"I really appreciate that, John," I said. "I have been treated very well here. I don't have specific complaints. Morgan Stanley is a great firm, the research department is tops, and I am making far more money than I ever dreamed."

"So why do you want to leave?" he asked.

"I'm just really impressed with the seriousness with which Merrill is approaching the telecom sector, the amount of resources they are throwing at it is huge, and the staff I will be able to hire there is larger than I would dare ask for here." In other words, I'm outta here.

Mack understood and wished me well. My mind was made up and he had plenty of other fish to fry. So I called Merrill's Andy Melnick and told him my decision was final. He arranged to send over movers in the morning to pack up my personal files and books. Then he called Rick Klugman, my associate at Morgan Stanley, and asked him to come down to Merrill so he could make an offer to him in person.

As I walked out of the office, thankful that my experience had been so great but equally excited for what came next, Linda Runyon, a bright, ambitious new hire who covered the cellular industry, accosted me. "You promised you'd stay here," she said angrily, her piercing eyes staring into mine. I had recruited Linda six months earlier and she made me promise to stay put. I looked at her and said, "Just stay by your phone." She, too, ended up shivering at Fraunces Tavern one morning. She came to Merrill with a huge pay raise a few months later, rose to the number one *I.I.* spot in the wireless telecom category,

and stayed there until her retirement in early 2005.

My move set off a wave of musical chairs throughout the entire telecom analyst community, mainly because the BT (British Telecom) deal was fast approaching and the British government had said they would hire only banks with *I.I.*-ranked telecom analysts. This musical chairs game was good for all of us because we all got major raises. There was a perception of scarcity out there, and we milked it for everything it was worth.

At Morgan Stanley, the executives scrambled to get a replacement for me. They went after Frank Governali at CSFB, a well-regarded analyst who had turned down the Merrill job because he didn't want the responsibilities of building a global team, especially the intense overseas travel that would entail. Frank agreed to take the Morgan Stanley offer, with a rumored price tag of $900,000, just one month after they had offered me $750,000. To add insult to injury, this one was guaranteed for two or three years and had nothing to do with the bankers making their budget. It was a nuclear arms race, with every analyst getting superpower status. Frank actually accepted the Morgan Stanley offer, but CSFB then matched it, agreed to let him relocate to Portland, Maine, and set up a one-man office just for him. So Frank decided to stay at CSFB.

Now it was April 1 and Morgan Stanley was losing valuable time. Someone suggested recruiting Jack Grubman from PaineWebber, since he was now ranked second, but Ed Greenberg put the kibosh on the idea, saying there was no way that Jack's style would fit at Morgan Stanley.

Panicking, Morgan Stanley hired Stephanie Comfort from Salomon Brothers, a young woman who had garnered enough votes to become an *I.I.* runner-up, behind two others and me. I'm not sure what she negotiated, but the rumors were around $800,000 per year. And her move opened up the Salomon position, which nine months later, in January 1994, ended up going to Jack Grubman. Jack scored a salary said to be the highest on the Street, rumored at more than $2 million per year. This made Jack, who had worked for PaineWebber, a retail brokerage with no significant banking business, suddenly part of a major investment-banking house. At the time, no one could have known what that would mean.

Privatization Pandemonium

I had negotiated a one-week vacation between jobs, but vacation

when you work on the Street is all relative. Merrill had dallied so long trying to get someone in this job that it no longer had any time to waste. Privatization was happening right now, and the big deal on the table was the competition to win a piece of British Telecom. The British government was preparing to sell off the last 22 percent of BT shares to the public.

The government would choose two banks, one British and one American, to lead the process, along with several "co-managers," banks that would play a smaller and much less prestigious role. BT would pay a total of 3 percent of the value of the offering proceeds as its fee, most of which would go to the lead managers. With the offering expected to total close to $8 billion, the participating investment banks could collectively earn a total of $240 million. Merrill wanted to break into the top tier of investment banks, using British Telecom as a wedge to do so. It desperately wanted a piece of the action.

So my trip to St. Martin with Paula—the first time we'd gone away alone in years—was hardly relaxing. Several times a day, the hotel concierge brought me a stack of faxes from Mark Maybell, the head of telecom banking at Merrill, who was preparing Merrill's presentation to the British government. Maybell wanted to include my views on BT shares. So I sat on the beach calculating subscriber-line growth rates and marking up draft slides while Paula read a book.

I did have time to read one book that week—*I Can See You Naked,* by Ron Hoff. It wasn't pornography, but rather a book intended to help inexperienced public speakers conquer fears of large audiences. The main suggestion was to imagine everyone in the audience is naked, while you remain clothed. This, the author said, would stop your heart from racing and your voice from quavering. I figured I'd need the naked trick with my new global responsibilities.

On March 10, 1993, I walked into the glass-enclosed towers of the World Financial Center, where Merrill had its world headquarters, directly across from the two World Trade Center towers that would be destroyed eight years later. I didn't feel the anxiety that I'd felt just four years earlier walking up Madison Avenue, but I wasn't exactly calm either. The money was great, and it was nice to be able to cover AT&T and to be out from under Ed's shadow. But the scope of the new job was much greater. Now I had global responsibilities and a global-level pay package too. I figured Merrill's top management would be on me like fleas on a dirty dog.

Moreover, unlike Morgan Stanley, Merrill had a huge retail system, the largest in the world—the most customers, brokers, and money under management. Although my research would remain directed at the sophisticated institutional investor, there was no doubt that Average Joe also was going to hear about my calls. More than 10,000 Merrill brokers would pick up the phone as soon as I got off the squawk box and try to talk someone into making a trade.

Brokers needed action to make any money, since their compensation was based largely on transactions. Analyst recommendations were jumped on and embraced like a new lover. Unlike institutional clients, who made their own investment decisions and used my research as one of many inputs, these brokers and investors might actually take every word I wrote or said as the gospel. Now that was scary.

I had no time to dwell on it. It was time to see the world. About 10 days later, on a Sunday night, Mark Maybell and I flew to London so that I could meet Neil Barton, Merrill's London-based European telecom analyst, and Merrill's telecom bankers there before we all went over to see the key decision makers at Her Majesty's Finance Ministry and try to make a good impression. Upon arrival, we quickly showered and suited up at 47 Park Street, a posh London hotel, while our drivers waited outside. I was fried, having skipped sleep in favor of going over every last shred of research and information just one more time.

Staffers at the Finance Ministry had made it clear that the U.S. telecom analyst would play a major part in its choice of a bank. The British government—and many others, I learned—believed that a bank's U.S. analyst could create a positive halo effect by using his or her influence to get investors excited about BT's shares. To judge influence, government bureaucrats used the *I.I.* survey as well as feedback about analysts they received from the largest buy-side institutions. They loved rankings because it gave them cover if things didn't turn out as planned ("Hey, that American magazine *said* he was great.").

But Merrill had a problem. It turned out that Neil Barton, Merrill's telecom analyst in London, had given BT shares a "3," or Neutral, rating. How, British Finance Ministry officials asked, could Merrill's brokers convince investors to buy a stock rated neutral? It was as if an IBM computer salesperson had to tell his customers that IBM itself had rated its own computers only "average" while giving other computers better marks.

Call me naïve, but I actually thought it was admirable to pitch with a "3"-rated stock. To me, it proved Neil's and, by extension, Merrill's integrity. As a result, I thought, Neil's research would be more trusted and thus more influential. Clearly, the British officials and my colleagues on the banking side didn't see it this way. Nevertheless, no one asked me to push Neil to change his rating. As expected, we didn't win a lead-manager spot for the BT offering—Goldman did. But we managed to land a co-manager spot, that unprestigious booby prize that generated very little work and equally little in the way of fees. It was a decent start, though.

The next morning (Tuesday), we boarded a chartered jet to Athens, where we had a "beauty contest," or a pitch meeting, at 2:00 PM to win the right to handle the privatization of the Greek national phone company. As with every meeting of this sort, before getting there I studied each phone company's history and growth rate. Then I modeled out the rate at which I thought competition would develop, based on that country's unique regulatory rules. Then I'd make projections of the company's future earnings and calculate a fair price for the stock.

As I reviewed my slides on the plane, I could already see that there was a pattern to this stuff: virtually all foreign telcos were monopolies facing only the beginnings of competition; all were fat pigs in terms of their inefficiency and gross waste, so had significant opportunities for improvement; and all were seeing a lot of increased demand, especially as cell phones came on the scene.

After our Athens pitch, we rushed back to the waiting private jet and returned to London, where I raced to catch an evening flight to Tel Aviv with another Merrill banker. The drill was the same there: meet as many people as I could who were involved in Bezeq, Israeli's telecom company, which was considering selling stock. Merrill's bankers had already spent many hours helping the government prepare. Now it was time to prove that we analysts knew a thing or two about the industry. I was wiped out—a four-hour overnight flight after the previous few days felt pretty brutal—but it was hard to complain, given what they were paying me. I spent a whirlwind two days in Israel, managing to have only a rushed dinner at Jerusalem's King David Hotel with my sister and her husband, who lived in that historic city, before heading back to the airport.

While waiting for my flight back to the U.S., I tried to call home, but my AT&T credit card wouldn't work. After several tries, an AT&T operator came on the line, asked me a few personal questions, and

then informed me that the company's fraud detection computers had cut off my calling card. Apparently, the computers deemed it impossible for anyone to have made calls from so many countries in such a short time, so the only conclusion was that someone had stolen my code and sold it to people all over the world. It had to be fraud! But it wasn't. It was just life as a telecom analyst.

It was all pretty heady stuff: analysts were suddenly gaining the attention and respect of the top executives and the bankers, who for the first time saw us as the key to their winning massive deals. And we were being brought into high-level meetings with government officials, including finance-ministry and regulatory commissioners, who would then look us in the eye and ask us how they should set up their own regulatory system.

I absolutely loved this part of the job; suddenly, I was the policy wonk I'd always wanted to be. Yes, there were bureaucrats just like those in the Department of Education, and sometimes, it turned out, their intentions were more about lining their own pockets than helping their country. But they were motivated to sell as much stock as possible at the highest price possible—and so were the investment banks.

The Perils of Papadam

This type of whirlwind schedule became the norm for me for several years running. My head would hit the pillow on a runway in New York and I'd wake up in Asia, or Europe, or South America every week or two. In an era when the computer was beginning to make electronic communications an acceptable form of doing business, my job was still all about the face time. If you didn't show up in person, you couldn't understand a company's basic reality, or the style of its top executives. And if those managers didn't meet you in person, it was pretty unlikely that your bank was going to win any business. Wall Street, I learned, was as much about kissing the ring as it was about massaging the numbers.

With the really big deals, we needed to roll out the big guns. In Indonesia, for example, where we were competing to underwrite PT Indosat, the Indonesian international long distance company, Merrill's president, David Komansky, flew in to say hello to the company's executives and government ministers.

I had met Komansky for the first time a few weeks earlier while

rehearsing our pitch back in New York. I liked him immediately. He was a hulking guy with a trader's mentality who had come up the ranks as a broker, ultimately running the equity desk. Komansky was paid $4.5 million in 1993, but he seemed to revel in his humble roots as the son of a postal worker in the Bronx. Next to "Danny Boy" Tully, he was the best flesh-presser I had ever seen. Merrill was lucky to have both, as government decision makers everywhere just adore that human touch.

All the investment banks brought in their big guns for these privatization presentations. Tully showed up in Germany in the battle for Deutsche Telekom's business, and Komansky and I flew to Madrid on one of Merrill's three private jets for a Telefonica de España pitch. We lost both of them. Win Smith, descendant of the venerable Smith family of Merrill Lynch, Pierce, Fenner & Smith and a Merrill executive vice president, came along on a privately chartered jet to Lima, Peru (we won that one). On my flight back from Germany, I sat across the aisle from Jon Corzine, then Goldman Sachs' co-CEO and future U.S. senator from New Jersey. He had just led Goldman's presentation to the German government and, like me, had to rush back to the Frankfurt airport and push through the crowds at the security checkpoint in order to make the day's last flight back to the States.

The funny thing about all of these meetings between senior bank executives and government officials was that the big guys never said anything of substance. Their job was to make small talk, jokes (nothing too culturally offensive), and then bring in the "experts" to show off the firm's technical qualifications. I was a straight man to their comedy routine.

Over my next six years at Merrill, as capitalist fever spread throughout the world, I traveled to virtually every country with a publicly-traded telecom company or with the near-term prospect of a privatization. My travels took me all over Latin America (Brazil, Chile, Peru, and Mexico), Asia (Malaysia, Thailand, the Philippines, Singapore, Hong Kong, China, Japan, and Taiwan), Australia, New Zealand, Israel, and much of Europe (France, Spain, the Netherlands, Denmark, Sweden, Germany, Italy, Hungary, and Greece). Merrill became the number two global underwriter of telecom privatizations, behind Goldman.

It sounds exotic. But every trip was made in the shortest time possible—often just overnight, even if it meant traveling 24 hours

each way for a two-hour pitch. After all, if I didn't get back and keep my investment ideas and face in front of my institutional investor clients, I would have no chance of getting *I.I.* votes—which would send my career into a tailspin.

Here's how a typical day would go: in order to get to Jakarta for a Monday morning meeting, I'd leave Saturday evening from JFK and fly to Amsterdam on Singapore Airlines. Staying on the same plane, I'd lay over for an hour in Amsterdam, where I could check my voice mail and call in any changes to reports my team had drafted. Then I'd fly to Singapore, arrive around 6:30 AM, connect to a one-hour flight to Jakarta, and arrive at about 8:30 AM Jakarta time. Elapsed time: 24 hours.

There was no time to relax on the plane, because I'd have a stack of articles about the country ready for perusing plus, if it was a banking trip, a three-inch-thick briefing book. Fortunately, Singapore Airlines was one of the first major airlines to install fully reclining seats in its first-class cabin, and that made a huge difference. I'd walk off the plane and be met by a driver, who would take me straight to the Park Hyatt or the Regent. I'd take what sometimes amounted to a $300 shower, since the room had been reserved from the night before.

After a change of clothes, I would rush to the first of many meetings that day. It was only as the day went on that things got brutal. Usually there were meetings stacked on meetings with the company executives from different departments—the marketing folks followed by the finance people, for example—and I had to stay alert and ask lots of questions.

Then came the hospitality portion of the visit: our hosts would insist on taking us out for a deluxe, booze-filled dinner showing off the culinary achievements of Indonesia. By this time, it was all I could do to keep my head from rolling off my neck, but it was time to be sociable. I didn't drink at these events, even though just about everyone else did. I could never keep up with the locals, not to mention the bankers. So I just didn't do it. Doubtless a lot of people thought I was a boring old teetotaler, but it was strictly for self-preservation.

The other problem I had was the food. I loved tasting every regional specialty, but let's face it: I am a guy from Buffalo with minor lactose intolerance. Sure, Buffalo is the home of spicy chicken wings, but add some funky spicy rijsttafel and papadam to my fast-developing jet lag and I was in big trouble. I'd sit there, listening to

the local Merrill banker flattering the company's CEO and CFO, praying for the evening to end. "Please," I prayed to the god of digestion, "hang in there, stomach!" Getting back to the hotel was often a race to the bathroom. It was an unanticipated downside of seeing the world.

But that wasn't the end of my day, either. By the time we'd get back to the hotel, it was 10:00 or 11:00 PM, which meant the markets were open in New York. So after calling home, I'd check in on how the telecom stocks were trading, get my messages, and read all my faxes, articles, and any draft reports.

Then there were the clients. Just because I was halfway around the world didn't mean I didn't have to carry on with their care and feeding. I'd stay up until 2:00 AM reading, checking voice mails, and returning calls. Finally I'd get in bed, but every few minutes I'd hear the scratchy noise of faxes being shoved under the door. I wouldn't be able to sleep much because of jet lag, so I'd regularly get up and check them, then check my voice mail again, and finally get up at 6:00 AM and start the whole process all over again. A long trip to Indonesia, believe it or not, would be two days.

Once, I had a few hours free, so I hoped on a flight to Bali and sat on the beach for an hour and then hired a driver to show me the religious shrines—just so I could say I had actually been to Bali and seen its treasures. Pathetic. I had to laugh: when they told me I'd be seeing the world, I didn't realize that meant I'd be seeing it through car windows.

Mississippi Madness

Singapore Airlines it ain't. That's what I was thinking as Rick Klugman and I boarded the decrepit 16-seat propeller plane from Atlanta, Georgia, to Jackson, Mississippi, one October afternoon in 1993. Because there were no direct flights from New York to Jackson, we'd flown to Atlanta first and laid over for two hours. All this in order to see some tiny long-distance reseller Rick was interested in. I didn't quite see the appeal, but I trusted Rick and figured he knew what he was talking about. Plus I'd never been to Jackson. If my move to Merrill was about seeing the world, wasn't a hotel room in Jackson as exotic as one in Jakarta?

The company was called LDDS, an acronym for Long Distance Discount Services, which pretty much summed up exactly what it did.

It leased excess long-distance capacity from AT&T, MCI, Sprint, or WilTel, a Tulsa-based wholesaler that installed fiber-optic lines inside its oil pipelines to carry phone calls. LDDS then resold the long distance service under its own brand to small businesses and residential customers. There were hundreds of these Mom-and-Pop-type long distance resellers, and the sector was ripe for serious consolidation. Merging many of these companies would create economies of scale in everything from sales to billing to technology. So keeping abreast of the most successful of these was critical for those of us who covered telecom. Although Rick handled most of the largest resellers, I'd often go with him when visiting a new company.

Rick had first brought this company to my attention right after we started at Merrill. Investors were asking about this LDDS outfit, he said, and he had to figure out what the deal was. I got the picture, although I already felt we were overextended: resellers were hot, in part because Jack Grubman had been the first of the rated telecom analysts to initiate coverage, with very positive ratings. Now the rest of us were playing catch-up while Jack enjoyed the better access and attention from these executives that came from having been the first to the party.

Our taxi pulled up to a seedy, sorry-looking Holiday Inn in the middle of downtown Jackson that just happened to be across the street from the equally forlorn LDDS world headquarters. We could have stayed somewhere more deluxe, but the choices were limited and I, by this time, valued 15 minutes more of sleep a lot more than some ultracreamy shampoo in a hotel room farther away. As I got ready for bed, I thought about this peculiar Wall Street ritual: the company visit.

The first visit to a public company is a weird combination of brownnosing and shoe-leather detective work. It's an analyst's obligation to thoroughly kick the tires of a company, to determine whether or not to launch coverage of the stock and, if so, where the gray areas and potential weaknesses lie. After all, the only thing worse than missing out on a hot stock is leading your clients into a bad investment and actually losing their money.

There was another side to the company visit too: the attempt to make nice with the management and gain their respect, or at least their belief that I could influence their company's stock price. If I was able to, they might be more forthcoming with information that would give my reports an extra edge, allow me to host meetings for them, or agree to speak at my conferences. Indirectly, there was the hope that

they'd also do some of their banking with Merrill, which might reflect well on me.

Hence, the ideal scenario for analysts was to find undervalued stocks, recommend them to investors, watch the stocks rise by virtue of good earnings reports that the analyst, ideally, had predicted, humbly accept credit, intelligently talk strategy with company executives, and then let the bankers try to sell the company M&A (merger and acquisition) and financing services.

All of these things were on our minds the next morning, October 4, 1993, at 9:30, when we walked into the dingy headquarters of LDDS. It looked more like a two-bit actuary's office than a national telecom company. But that was the essence of this company, a no-frills, cheapskate approach to telecom founded by Bernie Ebbers, a one-time gym teacher and milkman who got the name for his company from a waitress in a diner. As the legend goes, she wrote LDDS, for "Long Distance Discount Services" on a paper napkin as she served Bernie and his three buddies coffee. Never would a napkin receive such iconographic status, as LDDS went on to become MCI WorldCom, the most celebrated—and later, reviled—company in telecom history.

We were led into a conference room, where we were joined by the CFO at the time, Charles Cannada. Rick had prepared a list of questions, and we spent about 90 minutes discussing virtually every aspect of the business, from the cost of local access to the various sources of revenue. LDDS had already made some 50 acquisitions, all of which, it claimed, had been successfully assimilated into the company's operations and generated lots of cost savings in the process. The strategy was classic "roll-up:" buy the little guys, squeeze the costs out, and plow the savings into more acquisitions. When we probed further on the acquisitions front, Cannada suggested that we wait to talk to Bernie, the CEO, since he made all the major M&A decisions for the company.

Finally, Bernie Ebbers walked into the room. He was tall and thin, with an easy, long-limbed jauntiness about him that projected a casual confidence. Rather than the classic business suit the rest of us wore to meetings, Bernie dressed in cowboy boots, slacks, and a narrow string tie. He was from western Canada originally, but had come down to Mississippi for college on a basketball scholarship and stuck around, becoming a gym teacher and then buying a motel business before giving the telecom sector a whirl. I couldn't decide whether he had deliberately dressed down to demonstrate how informal and approachable he was or whether he had dressed up in his very best

duds.

Bernie didn't kiss our asses, probably because in the 10 months since Jack Grubman had launched coverage, the stock had shot up 63 percent. Jack had been the first to discover and tout the company to investors, and Bernie clearly appreciated it. LDDS had also just inked another acquisition—Advanced Telecommunications Corporation (ATC), a medium-sized Florida reseller whose CFO, a young man from near Albany, New York, named Scott Sullivan, would soon join the company as treasurer. A year later, in December of 1994, Scott was promoted to CFO, replacing Cannada. Bernie, Scott, and Jack would together create a partnership that would bring all of them riches and accolades for many years. Ultimately, however, that symbiosis would turn sour, creating a disaster not only for the three of them but for practically every investor and employee in the sector.

Bernie, Rick, and I had a pretty freewheeling conversation. We asked him whether there were more acquisitions to be made; yes, he assured us. We asked whether he'd have to sell out to a network company like Sprint or MCI at some point. He intentionally smiled at the *selling* question, but never in our wildest dreams did it occur to us that he'd end up actually trying to *buy* both of those much larger, established companies.

Bernie asked us questions, too; he seemed particularly interested in whether the Street preferred organic, or internal, growth to acquisition-fueled growth. He didn't ask us about how institutional investors viewed telecom, but he did ask about the types of stocks that Merrill's brokers liked. He clearly saw Merrill as a conduit to the individual investor.

Rick thought Bernie was a cool guy. He might be cool, I thought, but there was also definitely something a little off. I couldn't get a handle on him. Was he a smooth-talking salesman or the real deal? He was so different from the other telecom execs, who to a man were buttoned up corporate straight men with long careers in the industry. But a former P.E. teacher? What could he possibly know about telecom—or P/E ratios, for that matter?

For lunch, Bernie and Charles took us across the street to the Jackson City Club, at the top of a local bank building. It was probably the best view in Jackson, but it wasn't the Rainbow Room. We helped ourselves to the buffet lunch (I took it easy—southern fried food did me in almost as quickly as Indonesian) and kept talking. When we returned, Bernie invited me into his office while Charles took Rick

back to the conference room. Clearly, Bernie wanted to have a private chat with me. As I sat in front of Bernie's large, virtually empty desk, he looked me in the eye and pulled out a two-inch-thick loose-leaf binder. "Dan, you guys were asking a lot about additional acquisition opportunities," he said. "Let me show you our list." My eyes got big. Was he going to show me his planned deals? That would be absolutely proprietary information—info that, if I passed it along, could make my clients millions. Of course, having that information in advance, if he actually went ahead with the deals, would be the textbook definition of insider information. I just looked at him.

But it turned out that Bernie was only trying to show me that he'd done a lot of advance work. The notebook faced him, so I could see the page it was opened to but not exactly what was written on it, as it was upside down. And yes, when I say *written,* I mean *written.* The book was full of those green accountants' spreadsheets, and the figures and notations were all handwritten. Geez, I thought. It was 1993, 14 years after I had first learned to model financial forecasts on a desktop computer, and this company's CEO wasn't even working with Excel spreadsheets? Either this was one sharp old-school dude or he ran one very backward company.

"For each potential acquisition," Bernie explained, "I have a single sheet. Each sheet lists the synergies [cost savings] we think we can get in each of the first three years after we buy it. Each sheet also lists the impact on the first year's earnings. If the impact is positive, we can do the deal anytime. If the impact lowers our earnings per share, we won't do it."

I was amazed, first at the utter simplicity of Bernie's strategy, and second, at the fact that he, the CEO, was so involved in the small details of every potential acquisition. In my experience, those kinds of details were always left to the CFO, and the CEO's job was more to guide overall strategy.

But Bernie cared about the little things. He was intimately involved in the cost-savings side of the equation as well, scrutinizing each salesperson's weekly productivity, for example, and, as I later heard, monitoring the company's expenses for coffee and other office supplies. As Dave McCourt, CEO of a startup telecom company called RCN and also, for a time, a board member at WorldCom, told me several years later: "Bernie manages very simply: he watches every cost item very closely and, to keep the sales force pumping, every month he fires the lowest-producing salespeople and gives bonuses to

the highest producers. Believe it or not, it works extremely well."

Certainly, the numbers in Bernie's simple world were impressive: LDDS's stock price had a price-to-earnings ratio that was much higher than many other companies'. That was because LDDS's earnings were growing very fast and also because, thanks in part to Jack Grubman's support, it had attracted the momentum crowd, investors who were willing to pay high prices for companies that grew earnings rapidly and consistently beat investor expectations. It had a higher earnings growth rate because it kept buying companies that would actually add to earnings per share in the first year, and it was beating expectations, in part because it intentionally lowballed the cost savings from each acquisition. It was a virtuous cycle, so long as there were more and more acquisitions to make.

Having tempted me with his Stone Age spreadsheets, Bernie closed the notebook, moved it off of his spotless desk, and put it back on the credenza. As Rick and I headed downstairs for our taxi, I heard the parting words I'd hear from many executives in the years to come: "Dan, I sure hope you make us a Buy!"

We didn't. Rick initiated coverage of LDDS with an Accumulate rating, which was between a Buy and a Neutral. According to Merrill's definitions, a stock rated Accumulate was predicted to rise between 10 and 20 percent over the next 12 months. The report set a target price of $26.50, representing 11 percent upside from LDDS's current share price of $24. He also categorized it as "Speculative," the worst of Merrill's risk levels. Rick's report was fair, I thought, but not googly-eyed with admiration. It acknowledged all of the good things going on at the company but also mentioned the risk that the growth-by-acquisition story could run out of juice. I agreed with Rick's conclusions, but I hadn't told him what to write. He reported to me, but he was entitled to draw his own conclusions.

Two months later, after the stock had reached Rick's target price, he downgraded LDDS to Neutral. Using Merrill's definitions, this meant that he was predicting the stock would fluctuate somewhere around 10 percent above or below its current price in the next 12 months. Bernie wasn't happy. From that day forward we would have a very testy relationship. He clearly wanted a Buy rating from us, as it would bring in a whole new cadre of potential investors—Merrill's huge individual investor base—which might, in turn, boost LDDS's stock and enable it to be used to buy additional companies. Rick's rating did the opposite, since retail brokers were not about to waste their breath pitching a Neutral-rated stock with "speculative" risk to

their clients. Even Accumulate-rated stocks, also called Outperform or even Buy at some firms, did not interest many professional money managers. After all, they wanted a few great stocks to put into their narrow list of stocks to own. As such, even 10–20 percent upside sometimes didn't look so enticing, especially if it carried high risks as LDDS did.

I think that Bernie was also insulted by the fact that I delegated the lead coverage role to Rick instead of taking it on myself. This signaled to him that I didn't consider LDDS enough of a major company to merit my full attention. It was true: I never thought Bernie's company would become a major player. Moreover, I had my hands full and it was Rick who knew the reseller market best and who had brought this company to my attention. Rick had earned the opportunity to cover this strange company with the weird—or was it cool?—CEO.

Even when I later took over coverage and upgraded the stock for a while, my relationship with Bernie remained strained. My employers got very little banking business and it was always a struggle to get Bernie to speak at my Global Telecom CEO Conferences. The analyst's job, it turned out, was a lot more complicated—and personal—than simply writing reports and rating stocks.

3.RAINMAKER, DEALBREAKER

1993–1996

The leak hurt my institutional clients, too, not to mention the individual investors, who weren't privy to this kind of information. Or maybe it hadn't been a leak. Maybe she misunderstood what was said in the earlier phone call. Maybe he had called after the market had closed. I really hoped so.

Fraud 101

As I KNEW FULL WELL BY NOW, the Street stops for nobody. And this Tuesday in late May 1994 was no different. I had gone to the New York Eye and Ear Infirmary that morning to sit with my brother Mark, whose daughter Jennifer was having emergency eye surgery for a detached retina she got while boxing, believe it or not. I had meant to be a supportive brother and uncle, but I ended up spending the entire day oblivious to the surgery and glued to the hospital's bank of dirty pay phones. I was listening to a surreal conference call that would cause the fortunes of one of my favorite companies, IDB Communications, to implode as quickly as if it had been punched in the face by my niece. This was my first experience with corporate accounting fraud, and it wasn't an experience I ever wanted to repeat.

Back in early October of 1993, about the same time Rick Klugman and I were visiting LDDS, I received a phone call from a San Francisco–based Merrill investment banker urging me to take a look at a rapidly growing company called IDB Communications. IDB was a global satellite company that transmitted such events as the first Gulf War and several major rock concerts. After an astounding string of early successes, it began to use its highly valued stock to buy up international long distance companies. By 1993 it had become the fourth-largest provider of international long distance services behind AT&T, MCI, and Sprint, with the fastest growth rates and highest profit margins in the industry. Now called IDB WorldCom, after its recent acquisition of a small company called WorldCom, the company

was based in Los Angeles.

Around the same time, I received a similarly enthusiastic call about IDB from a Merrill broker in our Los Angeles office. I had made a habit of not returning retail broker calls because I saw my job as working with institutional clients only. But for some reason, I returned this one. The company seemed interesting enough to warrant a quick look, so I flew to Los Angeles a few weeks later to meet its CEO, Jeffrey Sudikoff; president, Ed Cheramy; and CFO, Rudy Wann.

Jeffrey Sudikoff was smart and, though a newcomer to telecom, had developed an impressive understanding of international telecom. He had started IDB with a $15,000 car loan and had ended up with one of the fastest growing companies in the country and a piece of the Los Angeles Kings hockey team. Ed Cheramy was a very overweight, slick, jewelry-encrusted sharpie who had previously been a partner at Price Waterhouse, one of the world's largest and most respected accounting firms. Though loud, flashy, and hardly my type, he, too, displayed a thorough grasp of the arcane rules and economics of the international telephone regulatory system.

I did some math on the flight home and concluded that my team and I should dig deeper. It seemed like a great opportunity to get in on the ground floor of a small but rapidly growing company and to beat Jack Grubman and my other competitors to the punch by being among the first to cover the company. Plus, Merrill's brokers adored small companies with big, albeit risky, upsides, just like the typical retail investor, who for all of his claims to the contrary, just loved the romance and the possibility of a hot stock.

I asked Megan Kulick, a 24-year-old junior analyst whom Rick and I had recently hired from Arthur Andersen, to research the international market and to work up a forecast for IDB. Assuming just small market share gains, which was conservative given that IDB was adding service to two-to-three new countries per quarter, our forecast indicated that the stock had lots of upside.

I was excited—it wasn't every day that I had the chance to come out first on a stock—but Dick Toole, my colleague and Merrill's longtime telecom and utility analyst, wasn't. He warned me he had looked at IDB a few months before my arrival, and decided to stay away. Too flashy and too fast growing for a conservative old-timer like Dick, I said to myself.

I initiated coverage of IDB on November 16, 1993, with a Buy

rating, the highest on Merrill's scale. I worked on the report with Megan, an independent-minded, hardworking woman with a great attitude and a great work ethic, and I thought it was the most comprehensive analysis we'd ever produced. Merrill's institutional salespeople loved the report and began taking me around to the professional investors who specialized in small and medium-sized companies often overlooked by Wall Street research analysts. I was introduced to a whole new cadre of buy-siders and, I hoped, *I.I.* voters. For a while, I looked like a frigging genius: in the four months since I had recommended buying IDB, IDB shares had surged 33 percent.

There was just one little problem. The company had a great business plan, but Jeffrey Sudikoff and Ed Cheramy had no idea how to execute it. As a result, the company's revenue growth started to slow dramatically just as the pressure to continue hitting its numbers intensified. If the company didn't make its revenue and profit estimates, the stock would surely tank. Such was the life of a high flyer.

So what did IDB do? According to federal prosecutors, it lied to its investors and the analysts who covered it. To hide the shortfall, the company faked revenues, among other things manually backdating a customer's order sheet so that an extra $5 million could be booked as revenue in the first quarter of 1994.[1] In the kind of admirable accounting work that would later go out of fashion, Deloitte & Touche, IDB's auditor, discovered the fraudulent bookings and demanded that they be reversed. But Ed Cheramy, a former audit partner himself, simply refused to make the changes and tried to intimidate the Deloitte folks into staying mum. The company brazenly reported the fake first-quarter numbers anyway, announcing "record revenues and earnings." A few weeks later, on that May Tuesday, Deloitte resigned the account, and I heard the news when my pager vibrated as I sat at the hospital with my brother.

I bolted over to the bank of telephones and called Megan, who told me that the company was holding an investor conference call in 15 minutes. I was shocked and scared; I had had no idea that there was anything wrong at IDB, and this was my first run-in with numbers that weren't what they appeared to be. I had no idea whom to believe, nor whether I should have somehow been able to suss out the falsehoods. What would my clients think? Was my stodgy old friend Dick Toole right, after all?

Amazingly, on the investor conference call, Jeffrey Sudikoff and Ed

Cheramy had the gall to rant about how unprofessional Deloitte was, insisting that IDB had done nothing wrong. Jeff was on the call from Germany, where he was, he declared, rustling up more international traffic deals and acquisitions. Ed was indignant, saying Deloitte had no right to question his and Jeff's integrity. This was simply a personality clash, Ed claimed, full of piss and vinegar, not an indication that there was anything wrong with IDB's financial performance. Next, IDB's CFO walked through the accounting adjustments requested by Deloitte, some of which the company was making and some it simply refused to do.

I felt as if I'd been punched myself as I listened with one ear to the conference call and with the other, on another pay phone, to Megan relaying the panicked messages coming in from clients and brokers. Since I had been the most visible and was thus the most embarrassed proponent of IDB shares, I asked tons of questions on the call.

I felt like a prosecutor interrogating a defendant. I went item by item: Why did Deloitte question this? What evidence do you have to refute them? How do we know there are not other things hidden underneath all this mess? I was midsentence in my stream of questions when the elevator opened and out rolled Jennifer on a surgical cot, head completely bandaged, en route to her recovery room. I would have waved, but both of my hands were holding phones. My relieved brother sarcastically thanked me for distracting him from the surgery.

It was obvious that this stock was going to crash as soon as it opened for trading the next morning, and that the situation was more than simply an embarrassment. Merrill was also likely to be the subject of a variety of class-action suits on behalf of its retail investors who had followed my advice. Clearly, I had to get rid of that Buy rating before the market opened.

But the company was truly unanalyzable. It did not have audited financial statements because the auditor had resigned, meaning that every line item on the financial statements was up for debate. It appeared that the executives were covering up a major revenue shortfall. And the nasty and public squabble with the company's current auditor meant that it was going to be extremely difficult to find another reputable firm willing to perform future audits.

I downgraded the stock to Neutral before the market opened the next morning. I told the Merrill sales force there was no way to know what IDB's true numbers were in the past, let alone to forecast its

future. I said the stock was going to get crushed, perhaps cut in half, and that from that price, it would likely trade sideways for quite a long time—hence the Neutral rating. It was too late to put a Sell on it; the stock would react to the news before anyone heard my report. And to argue it was oversold and therefore deserving of an Accumulate or Buy rating would have been irresponsible, since there was no way to know what the company's real financial situation was.

Merrill's lawyers had worked all night reviewing my written report to ensure I didn't create even bigger problems for them. They told me to read the report verbatim at the 7:30 AM Merrill morning meeting and not to veer from the script. As soon as IDB shares opened for trading later that morning, they lost almost half of their value.

Sudikoff and Cheramy were indicted on a litany of fraud charges, along with insider trading. I was subsequently interviewed several times by the U.S. Attorney's Office in Los Angeles. Yet despite what seemed to be clear evidence of extensive fraud at IDB, in a settlement with government prosecutors Sudikoff pleaded guilty to only three charges, including insider trading. In December, 1999, Sudikoff was sentenced to a year in jail and a fine of $3 million, though he allegedly made $4.6 million of profits on his IDB stock sales.[2] He admitted to selling IDB shares through an offshore account when things were falling apart, but before the public knew. Cheramy pleaded guilty to only one charge of securities fraud. His sentence: three years probation, 500 hours of community service, and fines of $250,000, although he, too, sold millions of dollars worth of IDB stock before the accounting issues reached the public. Additional fraud charges—that carried much stiffer penalties—were inexplicably dropped by the government.[3]

For me, the whole experience was a very serious reminder that management can't always be trusted, that some executives think they are above the law, and that I needed to be more vigilant. Ironically, I also learned another lesson, one that would serve me very poorly later on: accounting firms can be trusted to stand up for the investor and resign when a client insists on using improper accounting. Deloitte had lived up to the auditing profession's principles and maintained its independence. Subconsciously, I suppose, I thereafter relied more on audited statements than before. Although it would take another six or seven years for me to realize this, it was exactly the wrong lesson to learn.

The one company that benefited from the collapse of IDB was

LDDS, which snapped up the broken company's assets for a song. LDDS got something else from IDB WorldCom, too: a new name. Liking the sound of WorldCom, Ebbers and company absorbed it as their own. Its new name was LDDS WorldCom. They didn't seem to mind the fact that it had a whiff of scandal about it.

Tone and Notice

It was around this time that the pressure on analysts to do extra little things that might help out a banking relationship began to build. In mid-1994, I got a call from Matt Bowman, the Merrill banker covering MCI. Matt was also a neighbor of ours, and our kids played on the same soccer team. We got along great. Matt was a vice chairman at the firm and an outstanding investment banker, one who orchestrated so many of Merrill's own M&A deals that "Danny Boy" Tully called him "my investment banker."

With a touch of embarrassment in his voice, Matt told me that Doug Maine, MCI's CFO, had called him. Maine was serving on a committee set up by the American Electronics Association to oppose the expensing of stock options on a company's income statement. The Financial Accounting Standards Board (FASB) had come out in favor of expensing the options. But later, under enormous pressure from Congress, which had been lobbied to death by technology companies and startups in particular—which saw the stock option as the ideal way to compensate employees—it backed down from its earlier opinion.

So why did Doug Maine call? It turned out that he wanted me, as a "respected analyst," to testify before Congress—and tell them that I thought it was a mistake to expense options. "MCI's an important client, Dan," Matt said, "and the entire tech industry's really concerned about this issue." The thing was, I had never thought much about stock-option accounting before and it was quite possible my conclusions wouldn't be the same as Doug's.

"Hmmm, Matt," I said, trying to wriggle out of it, "I guess I should be flattered that he thought of me, but I'm not really very comfortable in such a lobbying role. I'm not even an accountant. And once I study the issue, who's to say that I'll come out in support of Doug's position?"

Matt's response was extremely professional. He clearly was not surprised by my answer, and didn't complain about it, even though he knew he'd have to go back to Doug with a big no. I'd just made his job

—and perhaps mine—more difficult. “All right,” he said, “I’ll tell Doug you’re not comfortable doing that.” I never heard another word about it.

A few months later, I was able to make good use of something I’d learned when I worked in MCI’s investor relations department, though it didn’t help my relationship with the company. One day in November 1994, when I had MCI rated as a Buy, Merrill’s highest rating, I’d gotten to work, as I always did, at 7:15 AM, and spent the hours before the market opened returning phone calls and talking to salespeople and traders.

As 9:30 approached, the trading desks always became frenetic, with traders yelling orders and market rumors being tossed back and forth across Merrill’s football field of a trading floor. For me, in the quiet of my office 16 floors higher, it was also a tense time of the day. Had any telecom companies issued press releases? Were any of my stocks making unexpected moves? Had I missed any news? Was anyone else announcing an opinion change? Ideally, I wouldn’t find myself on the wrong end of the information flow, but it did happen.

And that was the position I found myself in that chilly morning of November 28 when, just 15 minutes after the market opened, a Merrill trader called, barking that he was seeing some large sell orders on MCI shares. Already, the shares were down 5 percent to $19 from $20. The sellers were offering MCI shares for sale in larger-than-normal blocks. The trader might have known who the seller was, but he was sworn to protect the confidentiality of his client’s trading intentions.

Five percent down was a big move, yet there was no news out, so I went straight to the source, Connie Weaver, MCI’s director of investor relations, to see if I had missed anything. I got her assistant, whom I knew from my days in the MCI IR department. Lucky me. “Hi, Dan,” she said warmly. “Connie and Doug are in Boston today, visiting investors.”

The lightbulb clicked on. Had this trip been planned in advance, some of my Boston clients would have mentioned that MCI was coming to town. Knowing this, I would have called the analysts I worked with at Fidelity at 9:00 AM, right after the meeting, to see what had gone down. But no one had said a word. So a last-minute trip to Boston could mean only one thing: MCI was playing its patented hot/cold game from the old days! The company was probably seeing softness in its results and wanted to lower expectations before the

holiday and postquarter "quiet period" set in, when the company would no longer be allowed to discuss numbers until its earnings were released.

I spent the rest of the day trying, without success, to confirm this, but I knew in my gut that the company was doing its thing and that no one else understood it—no one else, that is, other than a few "well-informed" money managers in Boston. This was all before SEC chairman Arthur Levitt's Regulation FD (Fair Disclosure), which outlawed the release of information to any investor group without making it available to all when it went into effect in 2000.

Connie Weaver didn't call me back until 2:00 PM. I was not happy, because I needed to understand what had changed in MCI's business before I could rework my forecast and target price for the stock. She told me MCI was seeing some weakness in sales to midsized corporations, likely due to price-cutting by AT&T, and she didn't fight back when I suggested I would need to lower my forecast. After talking to her, I knew my suspicions were right: the company was trying for a gentle landing with its bad news by telling the institutional investors in Boston before any others.

It appeared the long-distance price wars were more intense than I had been predicting and it was time to reduce my rating. The next morning, I downgraded MCI shares two notches, from Buy to Neutral —meaning I now thought MCI's shares would hover within 10 percent of their current price over the next year. I also cut my rating on Sprint from Accumulate to Neutral, assuming that the problems MCI was facing were industry-wide. As it turned out, my concerns were justified: two weeks later, Sprint announced fourth-quarter price pressures, and early in 1995, both Sprint and MCI announced disappointing fourth-quarter revenues and earnings.

The day after I issued my MCI downgrade, Matt Bowman, the Merrill banker, called to tell me that good old Doug Maine was not happy with my decision. "Dan has a right to his own opinion," Doug apparently said. "I respect that. But I am not happy with the *tone* of his report. And he should have given us *notice* in advance."

"Tone" and "notice." I had to laugh. I immediately understood what was going on: his complaint about my "tone" was simply another way of saying he disagreed with my decision to downgrade (believe me, I never got the tone complaint on an upgrade). And "notice" was just another way of asking for time to get a rebuttal ready. If I had informed Doug the day before that I was going to

downgrade, two things might have happened. First, he might have called Matt Bowman, and perhaps MCI's CEO, Bert Roberts, would have called Merrill CEO Dan Tully, urging them to get me to reconsider.

Second, with "notice," Connie Weaver and MCI's investor relations department could launch a preemptive strike by calling important stockholders and countering my argument. What nonsense, I thought. They want to control what we analysts say, and they want the complaint registered via Merrill's bankers, hoping the message comes through: if you want our banking business, make sure your analyst is good to us.

I can't tell you how many times I would later hear the "tone and notice" complaint from corporate executives who didn't like what I had to say, but it was something of a novelty at the time. Anyway, I didn't pick a fight with Matt and he didn't with me. I just told him to please tell Doug I was sorry, but I didn't think I should notify anyone of my downgrade before it had been officially announced at Merrill's daily meeting for the 150 institutional salespeople and thousands of retail stockbrokers who listened in via a loudspeaker system known as a "squawk box."

In March 1995, I hosted my annual telecom conference, as I had done the prior year and would do for the next seven years. Virtually every major telecom CEO would make an appearance, and over the years it became an event where one could expect some big deal to be announced or important news revealed. It was a great place for executives to interact with major investors, other executives who might be interested in a deal of some sort, and Merrill's analysts and bankers. Although MCI CEO Bert Roberts had raced back from a board meeting in London to speak at my conference the prior year, this year he was suddenly unavailable. MCI CFO Doug Maine was sent along as his replacement. The thing was, it was a CEO conference. We all suspected what was going on: this was retribution for my downgrade.

Jack's Knack

Back on the international front, the pace of privatizations continued to pick up, and with it, the intensity of the competition to underwrite them. By 1995, a few firms were emerging as the clear leaders. Goldman Sachs got the biggest piece of the pie, in part because it had Robert Morris, who for the nine years through mid-1994 had been the number-one-rated telecom analyst. Although Merrill was late to the party, its global brand and sheer size made it number two, winning

the lead in such privatizations as France Telecom, Portugal Telecom, Indosat, and Telefonica del Peru.

Others, like Salomon Brothers and Morgan Stanley, found themselves fighting like hungry dogs over the smallest pieces of business. We know what was going on at Morgan—their U.S. telecom analyst was inexperienced and not highly ranked—but what about Solly? Salomon was the setting for *Liar's Poker,* Michael Lewis's book on Wall Street, and it was known as an aggressive trading firm with a weak banking franchise (this was before Salomon was acquired by Travelers' Smith Barney unit and then Citigroup). Salomon did, however, have Jack Grubman as its new telecom analyst. A year earlier he had moved from PaineWebber with great fanfare.

By this point, a bank's research analyst was beginning to be one of the most important factors determining which investment banks companies and countries chose to handle their deals. Our research still mattered, but our reputation—ostensibly coming from that research—mattered a lot more. And Jack Grubman, because he had been out front on some of the new, growing companies and because of his aggressive self-promotion, now mattered the most of all. Jack's contract to move from PaineWebber to Salomon was probably near $2 million per year for three years, easily making him the highest paid analyst on the Street at the time. It made sense, if such pay packages could ever make sense, because the telecom industry was fast becoming the deal center of the world and Jack was the most prominent analyst to move at that time.

By October 1994, Jack would displace Robert Morris to become the top-ranked U.S. telecommunications analyst in the *I.I.* poll. This should have given him a huge edge with foreign government officials choosing underwriters, but it didn't, mainly because of his personality. Jack came across as pompous, constantly telling management what to do and how to run their companies. He was loud, self-centered, and every sentence he started seemed to begin with "I." But foreign civil servants didn't really go for the use of the first person. They were bureaucrats, and they preferred the calm, steady, and more respectful (okay, a little bit staid) voices of Robert Morris and me.

Although Jack and I had the same job, just about everything about the way we did our jobs was different. Mark Landler, a reporter for *The New York Times,* would later write a story calling us the "Siskel and Ebert of Telecom Investing," and his description was spot-on. "Mr. Grubman, 43," he wrote, "is the swashbuckler, who boasts about his close ties to the chief executives of the big telephone companies and

whose research reports sometimes read more like polemics than dispassionate studies. Mr. Reingold, 42, is the Wall Street wonk, who cultivates a network of contacts in Washington to gauge the direction of legislation, and who showers his clients with a stream of briefings and updates."[4]

When it came to privatization, wonk seemed to be working out better than swashbuckler. Yet Jack's failure to win foreign deals was not for lack of trying. Like me, he practically lived on a plane for years. I ran into him all over the globe, crossing paths in Australia, Germany, and Peru. In fact, in Peru, I saw Jack on the steps of the Finance Ministry, where our respective pitch teams of bankers and analysts were being chased by paparazzi, eager for a shot of those helping to put together Telefonica del Peru's upcoming IPO. I guess the arrival of modern capitalism in the form of a bunch of American Wall Streeters was bigger news in Peru than the latest Shining Path terror attack.

Making matters worse for Jack was the fact that when he was recruited, he had promised his Salomon bosses that he'd help them snare big investment-banking deals. Soon after Jack arrived at Salomon, a former Salomon analyst later told me, Jack had boasted at an internal departmental analyst meeting that he would help bring in $40–$50 million in banking fees in the next year, a huge score at that time. So far, it wasn't happening, although he was being paid, in part, for that claim.

To its credit, Salomon was quick to realize that Jack didn't play well overseas and that they needed to find a better use for their costly new hire. Jack knew it too. The solution was closer to home, in a new emerging category of telecom companies: the local startups such as MFS and Teleport, which offered local phone service in competition with the Baby Bells, and later, long-distance broadband companies, such as Qwest and Global Crossing, which would compete with AT&T, MCI, Sprint, and WorldCom. The startup local carriers offered lower prices than the Baby Bells because their technology was newer and more efficient, and because their workforces were nonunion.

Jack was one of the very first analysts to see the potential in these emerging telecom startups, and here his brash personality was a perfect fit. Start-ups are run by risk-taking entrepreneurs, people who don't take no for an answer and people who like to move fast. Before Jack arrived, Salomon had already sponsored the IPO for MFS, one of the two first local telephone startups in the U.S. Jack quickly adopted MFS and its CEO, Jim Crowe. Jack became the patron saint of the

local startups, drooling over every one he could get in to see, and recommending almost every one that hired Salomon to underwrite its stock or bonds. His became the loudest voice heralding a new, hungry, and aggressive type of telecom company. And the louder he talked, the quicker his bosses at Salomon forgot about the failures overseas. This group of startup local phone companies would later become a new category in the *I.I.* rankings, and Jack owned it: from 1999 through 2001, he was rated number one.

I, too, believed that many local startups would do well. * But my colleagues in Merrill's investment banking department were at a major disadvantage: by the time the local carriers began going public and raising money a few months later, I had already decided to upgrade their biggest competitors, the Baby Bells. Most local startup executives hated the Baby Bells and distrusted anyone who felt positively about them. Plus, Jack was far more vocal in his bullishness on the local startups, seeing virtually unlimited upside, and he was conveniently bearish on the Baby Bells, which, incidentally, were cash rich and thus didn't need to raise money like the startups did. That endeared him even more to the local startup managements.

But that wasn't Merrill's and my only disadvantage. One day in April 1995, Frontier, a midsized phone company based in Rochester, New York, announced that it was buying ALC, a long distance reseller based in Birmingham, Michigan. The announcement came just after the market closed at 4:00 PM, and clients began calling right away to see what I thought of the deal. I didn't cover either stock at the time, but I was paying attention to the growing consolidation in the industry and thought the price was a fair one. I put in a few calls to larger clients, to give them my views and see what they thought.

At about 4:45 that afternoon, a buy-side fund manager called me, ostensibly to see what I thought of the deal. I detected a strange note in her voice, and wondered if she'd had a rough day or made some poor picks. I had launched into my spiel about how I believed that it would be better for the industry to reduce the number of players when she suddenly cut me off.

"You won't believe this, Dan," she blurted. "Jack called me at a quarter to four and told me this was going to happen."

How could he have known? Had he heard a rumor or been tipped off by someone within one of the companies? Or had Salomon's bankers put the deal together and brought Jack over the Wall, as Ed

and I had been with AT&T and McCaw? It turned out Salomon was, in fact, the banker advising ALC. If what she'd said was true, Jack might have been an insider and leaked material inside information before the deal broke. In legal terms, that could make her a "tippee" and him a "tipper." She could easily have bought or sold the stocks based on advance knowledge—the clear definition of insider trading. The obvious move would have been to buy ALC shares and sell whatever Frontier shares she held in her fund, since the acquirer's stock often falls upon announcement of an acquisition. Indeed, the next day, Frontier's shares fell 13 percent and ALC's rose 9 percent, shifting aggregate market values by a total of $3 billion. I was so shocked—and furious—that I was speechless for a few seconds.

"You're kidding me," I shouted.

"I'm serious, Dan," she responded. "It makes me really uncomfortable."

"Why would he do that? What did you do with the information?"

"Nothing," she whispered. "I know I can't use stuff like that."

I hung up the phone and just sat there for a second. How could Jack so blatantly disregard the law? Why would he take such a crazy risk? Anybody who was willing to leak inside information was not going to last long in this business.

What I thought about most, however, was how unfair a game this was. This guy was my rival; how was I supposed to compete with someone who was trying to win favor from clients by passing on inside information? The leak hurt my institutional clients, too, not to mention individual investors, who weren't privy to this kind of information.

Or maybe it hadn't been a leak. Maybe she misunderstood what was said in the earlier phone call. Maybe he had called after the market had closed. I really hoped so.

Afternoon Tryst

For now, Jack's added edge wasn't hurting my career. Sometime in May 1995, Connie, my executive assistant, walked into my office with a worried look on her face.

"John Mack is on the line for you," she said.

Connie knew that Mack was the head of Morgan Stanley, and she'd been an executive assistant long enough to know that if the head of another firm called, something big was definitely up. I had promised Connie when I hired her two years earlier that I planned to work for ten more years and that she'd be with me until the end. She probably didn't believe me, but we had shaken on it.

"Hi, Dan," John said in his North Carolina drawl, sounding as casual as if we'd spoken the day before for 60 minutes, not two years earlier for only six. "I'd like to have dinner with you. How's next Monday evening?" It was becoming pretty prestigious to be an analyst all of a sudden, and to have the head of a rival firm call was still a very, very big deal. I knew it was a recruiting call—there was no possible alternative explanation—and wondered what had happened at Morgan. Was Stephanie Comfort a flop? Was Ed Greenberg behind this? And how did they get Mack to make such a call, one I'm sure he saw as a level of groveling that was beneath him?

"Sure, John," I said. "How can I say no to an invitation from John Mack? But I want you to know I am very happy here at Merrill and am not seeking a change at all." (It was the ritual language used by all targets of a headhunting. Plus, it was true).

"That's fine, Dan," John responded. "Let's just get together and we'll worry about the rest later. You live in Westchester, right? Meet me Monday evening at seven at the Cobble Creek Café in Purchase."

I have a terrible habit of smirking when something good is happening, and Connie knew this, so she came in and hung around for a few minutes to see if she could detect any odd facial expressions. She knew that I wasn't going to put anything on the calendar, but if I did schedule any secret meetings over the next few weeks, she would know: either I'd arrive late to the office (which I never did unless I had an appointment that she always knew about), leave early (which I rarely did except to get to one of the kids' softball or basketball games), or go out for lunch (I always ate at my desk except for client or company meetings).

John and I arrived at Cobble Creek Café at the same time and walked in together. It's a nice place with decent food and a countrified setting. And on a Monday night it was pretty quiet and the bar area was empty, so John asked the owner, whom I surmised he knew from numerous other meetings like this one, if we could have the bar area

to ourselves with the door closed off from the main dining room.

I was pretty sure that I wasn't going to leave Merrill. I was still ranked number three by *I.I.* and to win the *I.I.* sweepstakes, I reasoned, I needed the huge client base and public exposure that Merrill's combined institutional and retail distribution systems offered. But I had learned that it was always best to listen—especially when John Mack was talking.

The first impression I'd had of Mack was that he was a laid-back, southern gentleman. This was anything but true. His accent was somehow soothing, but on this night, Mack was all business, skipping the small talk about the kids and the families. He apologized for whatever had gone wrong back in 1993 and said he and the entire telecom banking team wanted me to come back. He assured me that things were different now that he had handpicked the new global head of research, Mayree Clark, a woman from Oklahoma who had done terrific things in Morgan Stanley's real estate division. He also told me he was very focused on Jeff Williams, Morgan Stanley's head telecom banker, since John was not satisfied with his group's production and wanted it fixed.

The funny thing was that Jeff and Mayree were married, creating a very delicate situation. Mayree would be my boss, but her husband was the main telecom banker. Would I have independence, or would Mayree pressure me to come to bullish conclusions on companies Jeff was cultivating as investment banking clients?

I kept these thoughts to myself, figuring that there was no reason to give John the sense that I was a negative or high-maintenance guy. But we were pretty much out of things to talk about. I didn't golf at the time, which was John's passion, and John didn't seem to care about pro football, let alone the angst-ridden history of my team, the Buffalo Bills. The conversation slowly sputtered to a halt, but not before John asked me to have breakfast two days later with Mayree and a guy named Neil, who headed Morgan's equity sales and trading department.

The breakfast was set for the Mark Hotel, a small, exclusive place on the Upper East Side that was a lot more Morgan Stanley than Merrill in style. To my surprise, John Mack showed up at the breakfast as well, I guess to underscore the meeting's importance. I couldn't imagine that the head of a firm as large, complex, and global as Morgan Stanley was spending this much time recruiting one individual for the research department that actually lost money year

in and year out. But he was.

Mayree, an all-business type known for being a tough cost-cutter, was quite nice and enthusiastic. Neil was a bit gruff and more focused on his watch than on our conversation. But that's what all traders and salespeople are like, especially early in the morning before the markets open. Traders and salespeople abhorred breakfast meetings because they took them away from their desks and phones during the peak productivity part of the work-day. Neil had been ordered to be here, of course. He probably didn't know much about the telecom industry. He probably also had no use for research analysts except that analysts made the noises—upgrades, downgrades, earnings estimate changes, strategic commentary—that his salespeople and traders used to generate stock trades. Mayree described the changes she was making in the research department and Neil highlighted some recent successful IPOs that Morgan Stanley had underwritten. They seemed to be out to impress John more than me, but I was flattered anyway.

Before the breakfast ended, Mayree suggested a meeting with Jeff, her husband. She said she would get a suite at the Righa Royal Hotel at Fifty-fourth and Seventh for 3:00 PM the next Monday, and leave the key at the front desk under her name. It's hard to explain how strange it was walking into a hotel lobby at three in the afternoon, going to the reservation desk, and asking for a key left by a Ms. Clark. I'm sure the lady at the front desk thought this was an afternoon tryst. I guess it was, in a way: I was considering cheating on Merrill with my old flame, Morgan, after all.

Jeff was waiting in the suite, and he basically parroted John's line. Then Jeff left and Mayree showed up. She was ready to talk turkey. She offered me a three-year guaranteed deal at a total pay package substantially above what I was making at Merrill, including stock options and bonus. I was amazed. These numbers were mind-boggling. Even Morgan Stanley, the firm with "Mack the Knife" at the helm that was so resistant to paying analysts well two years earlier, had finally joined the stampede to hire the best analysts in the hope of landing big investment-banking and underwriting fees.

I managed to keep the telltale smirk under control and asked Mayree if I could think about it for a week or so while Paula and I took the girls on a quick trip to Pennsylvania's Amish country. She agreed, but also asked me to meet with Joe Perella, who had joined Morgan as chairman of investment banking, before I left. Joe was a legendary 1980s mergers-and-acquisitions banker who, with Bruce Wasserstein, had built First Boston into an M&A powerhouse. They

then bolted to start their own firm, Wasserstein Perella, known to Wall Streeters as *Wasserella.* I couldn't resist; I had heard his name a zillion times over the years and knew he was supposed to be the most persuasive salesman on the Street.

So the next day, I walked into Le Bernadin, Manhattan's top French seafood restaurant and a place where people went to be seen. Joe, a lanky, bearded, hyperactive sort, arrived a little late. Clearly something big was going down. He was frenetic, saying he needed to make a phone call. This was in the days when it was still a big deal to use a cell phone in a restaurant, but Joe didn't care. He pulled a huge clunky one from his equally clunky briefcase and dialed in, walking away for a moment so I wouldn't hear what he was saying. Then his battery started to run out, so he continued his call from the pay phone in the back by the men's room.

I had brought my briefcase, so I had plenty to read while waiting (and I also needed the time to decipher the French menu). Joe finally came back and we ordered. But we had barely made it through the pleasantries when he suddenly noticed Edgar Bronfman, Jr., heir and CEO of Seagram's, and his gorgeous Venezuelan wife sitting a few tables away. Joe bounded across the room to say hi and left me staring into my bouillabaisse.

I didn't really care that Joe was rude. He was, after all, a big swinging dick on Wall Street and I was actually getting a meal at Le Bernadin and a great view of how an M&A legend operates—they never sit down. We did eventually talk a bit. He was very excited about some of the changes he was trying to make to Morgan's investment banking department, and he repeated the mantra that telecom was an absolute top priority. Then, just as a throwaway line, he gave me some of the most important and useful advice I've ever received.

"Be sure to get really good legal assistance when negotiating your contract, whomever you end up with. If you want, I can give you my lawyer's number and I'll ask him to take your call." Sure, I said. Why not?

Mayree had an offer letter written up and overnighted to our motel in the Amish country. I wasn't sure what to do. Merrill had been great to me over the past two years. Everything they had promised—staffing levels, bonuses for staff, a top-notch executive assistant, no burden from retail, no banker interference—had come true. I needed to inform them of the offer and give them a chance to respond. It sounds

crude and it was. But on Wall Street, everything that can be quantified is.

And these dudes can move at the speed of light when they need to. After a quick trip to London, I immediately informed Andy Melnick, Merrill's head of domestic research, and Jeff Peek, head of global research, of the Morgan Stanley offer. Within four hours, they had approval to match it and said a new offer letter would be ready the next day. I know this must sound insane to people who work in companies that make real stuff, people who work for decades without a decent raise. But for an investment bank, a million here or there was a rounding error.

My next call was to Joe Perella's lawyer. I guess Perella assumed that I would use his lawyer to negotiate with Morgan, but the first thing I wanted the lawyer to do was to look at Merrill's letter. The lawyer reviewed Merrill's draft, which was very similar to the agreement I had been operating under at Merrill for the past two years.

"Dan," he said, "this is not a contract or a guarantee. It basically says they will pay you a certain base and a certain bonus but only if Merrill employs you at bonus time. But you'll get nothing if Merrill decides, for whatever reason, to fire you. You have no guarantee whatsoever."

I almost fell out of my chair. I thought I had a sure thing, and here was an expert lawyer telling me I didn't. Which meant, I realized, turning red, that both offer letters I had—the one from Merrill and the one from Morgan—were not worth the paper they were printed on. I've never felt like such a sucker in my life. Were all of us Wall Street employees with multiyear guarantees this stupid or was it just me? Had my Merrill bosses been laughing at my naïveté for the past two years?

I hurriedly asked the lawyer to send me his suggested changes, and I then sent them to Andy, who sent them on to the Merrill lawyers. After a few back-and-forths, all of my requests were granted. Merrill and Andy were suddenly willing to truly guarantee my pay with only one exception: if I broke a securities law or regulation. Now, like many of the chief executives whose stocks I covered, my pay was set, regardless of how well—or how poorly—I performed in the future. It was also set no matter what the investment bankers thought of my research opinions or me.

Thank you, Joe Perella and Morgan Stanley.

With the Merrill contract set, I had to decide what to do about the Morgan offer. Mayree was calling at home every other evening, asking me where I stood. Paula, as always, was my sounding board. And as always, she gave me the best advice of all. She reminded me that the momentum seemed to be going in the right direction at Merrill. Why mess with a winning formula? And why go back to where you started? They'd always remember you as that wet-behind-the-ears MCI guy who came to the Street not sure what a P/E ratio was.

That settled it. I turned Morgan Stanley down. It was amazing, ridiculous, actually: thanks to a few meals out of the office, I had the same job and the same responsibility—but at substantially higher pay and with a lot more job security.

My Major Opinion Change: Upgrading the Bells, Downgrading AT&T

By this time, I'd been at Merrill for two years. I'd been fairly consistent in my stock opinions since the day I'd arrived. I was negative on the Baby Bells, such as BellSouth, SBC, and Bell Atlantic, because I thought the regulators were doing things that constrained their earnings, and that deals like AT&T buying McCaw were aimed at bypassing what was called the local loop—the last bit of wire to the household—which was controlled by the Bells.

Everyone, from my coworkers to my clients, expected this to remain my position. And everyone liked it when an analyst had a clear and consistent position. "Oh, you know Dan. He hates the Baby Bells and loves the long distance companies." But around the middle of 1995, a series of events led me to change my views and begin recommending that my clients buy the Baby Bells instead.

It all started in mid-June with the passing of a bill by the Senate, the Telecommunications and Deregulation Act of 1995, that I believed would make it much easier for the Bells to get into the business of providing long distance services. Republicans were in charge of both houses of Congress for the first time in many years, and they were a lot more receptive to the Bell companies than the Democrats had been.

It suddenly seemed obvious to me that congressional sentiment was changing in favor of giving the Baby Bells more freedom. A motley but powerful alliance of many Republicans and a few

Democrats came together to support this legislation, including Democrat John Dingell, one of the House's most powerful members and a longtime supporter of the Baby Bells.

I did some investigating of the political environment, talking to congressional staffers, lobbyists, and attorneys I knew on the Hill from my D.C. days, and they backed me up: it seemed as if Congress was going to finally pass legislation that allowed the local phone companies to provide long distance services and encouraged the long distance companies to provide local service. It was called "cross-entry."

This was a big deal. Similar bills had been debated in every single congressional session on the topic since the breakup of AT&T in 1983, but those bills had died in committee as the industry's powerful interests collided and neutralized each other. Even though the Republicans were behind the legislation, it had come to be identified with Al Gore, who was at the time discussing something he called the "information superhighway," that is, the Internet. So although the Democrats didn't really support the bill, it was known as Al Gore's initiative, making it virtually impossible for President Clinton to veto it.

In early June, I asked Megan Kulick and Mark Kastan, who had been hired to replace Rick Klugman when he left for Grubman's former spot as PaineWebber's senior telecom analyst, to run a complex series of financial models assuming the Baby Bells started to offer long distance services under various time frames. Mark had been a client of mine as a buy-side analyst at the Bank of New York and J&W Seligman, a mutual fund manager, for almost 10 years and I was thrilled to have talked him into coming to work with me. He was a smart, somewhat sarcastic, ambitious guy who had the seasoned perspectives of a professional investor and added a new perspective to our team. We worked on the models for six solid weeks. I made up my mind in early July 1995, after I had visited buy-side clients in six European countries and was taking a quick vacation with Paula in Scotland. I left a voice mail for Mark and Megan telling them to swing into action. Then I contemplated the consequences of my opinion shift.

None of my competitors at other firms seemed to be focused on what was happening in Congress. So if I went ahead with a position change, upgrading the Baby Bells and downgrading the long distance companies, I'd be the first one out there to plant a flag. I'd surely get a lot of attention, and hopefully, I'd make my clients some good money.

There was only one problem: if I was wrong and this legislation didn't pass, I was going to look like a complete idiot. For my entire career, I had been cautious on the seven Bells. If I changed my mind, it was going to make waves. It would be the biggest call I'd ever made.

Further, my report would certainly upset AT&T, because I was now backing its biggest threats, the Baby Bells. Merrill did a decent amount of banking business with AT&T, but I didn't care; I now had a guaranteed contract. I had already downgraded MCI and Sprint to Neutral in late 1994 because of my concerns about long-distance price wars. The Baby Bells, of course, would be thrilled. Doubtless they'd think they'd finally managed to convince me of the folly of my earlier ways. Certainly my clients would be perplexed, and those who owned AT&T shares would not be happy at all. It would be their decision, of course, whether to listen to me or blow me off.

The argument itself was pretty simple—the legislative tide was shifting in favor of the Bells and away from AT&T and other long distance companies. This simplicity would make it very appealing to both Merrill brokers and sophisticated money managers. Yes, there were a variety of factors, such as the growth of new services like Caller ID, voice mail, and cellular phones, and of course, some loosening of the regulatory rules. But in essence, I was betting it all—perhaps even my career—on those Senate and House bills actually becoming law, and on key sentences in those bills not being lobbied into oblivion at the last minute by the long distance companies.

On July 18, 1995, I was the first speaker on Merrill's morning call. "For the first time in my career, I am turning bullish on the Bell companies," I announced. Unlike my first time on the call back in 1989 when I launched coverage of the telecom sector, this time I felt energized and confident. I might be making a huge mistake, but at least my point of view was well thought out and well reasoned. And no one in the banking department made a peep.

Immediately after the call, I dashed back to the office and hopped on the phone. I tried to call as many clients as I possibly could, starting with the largest and most important, like Fidelity. If they didn't answer, I'd leave a message. "Look," I said, "I wanted to make you aware that I've reversed my position. I'm downgrading AT&T to Neutral and upgrading all the Bells." My clients reacted in very different ways; some were intrigued, others listened quietly, and a few disagreed vehemently. Quite a few seemed surprised that I'd made the change at all.

And suddenly, I found myself in the spotlight. In September, *Barron's,* the required Saturday morning reading of every portfolio manager, ran a six-page interview with me, including several large photos taken at my home. *Wall $treet Week with Louis Rukeyser* called, too, asking me to be a guest on their December 15, 1995, show. At the time, the show, despite being among the most boring half hours ever to run on television, boasted the largest audience of any financial show on TV. Appearing on it was considered the financial world's equivalent of doing guest commentary on *Monday Night Football.* The show was targeted more toward the individual investor than my institutional clients. But I knew I had to do it, partly because Merrill had spent a lot of time lobbying the Rukeyser folks to invite its analysts on the show, and partly because I knew my mom and dad in Florida would get a huge thrill out of seeing me on TV.

It was a long seven months of nervous waiting, but my call was right. The legislation finally became law the following February, when President Bill Clinton signed the Telecom Act of 1996. Bob Allen, AT&T's CEO, ordered busloads of AT&T employees to protest in Washington as a last-ditch attempt to kill or change the bill, but it passed unchanged. And fortunately, the market seemed to agree with me: the Bells rose on average 32 percent from my July upgrade until the end of the year, beating the pants off the S&P 500 Index's 10.3 percent rise.

Once again, Jack attacked with a viewpoint that was squarely in opposition to mine. For him, long distance was a complex business that the Baby Bells couldn't learn quickly (I said it was simple); he said long distance companies like AT&T would take more from the local market than the Bells would in the long distance market (I said the reverse). And in a perfect parallel with his own approach to Wall Street, he argued that marketing skills mattered the most, far more than the physical connections to customers that I thought were key. Again, we were the yin and the yang of our industry.

The Power of the Poll

Even before my opinion change, my status on the Street had been changing. I was about to displace Jack as the top-ranked telecommunications analyst, according to the survey in *Institutional Investor* magazine that ruled our professional lives. To understand the *I.I.* rankings is to understand what really made a Wall Street analyst in the 1990s. Here's how this whole insane—or was it inane?—process

worked.

It all started with a twenty-eight-year-old named Gil Kaplan, a former American Stock Exchange economist trader who founded *Institutional Investor* in 1967, targeting big money managers. In the summer of 1972, Kaplan walked into the office of his editor, Peter Landau, and said, "We've got to do a story about the best analysts on Wall Street." The inspiration for just how to do that came that evening, when Landau and a colleague, Wayne Welch, were having drinks and watching baseball's All-Star Game. Since the story was slated for the October issue, the pair decided to give it a football theme, call it the "All-America Research Team," and put Wall Street analysts in football uniforms. "We laughed and laughed," Landau said. "Little did we know it would become this huge thing on Wall Street." The *I.I.* rankings were born.[5]

For people like Martha Stewart, springtime is planting season. For analysts, it was *I.I.* voting season. Every spring, *Institutional Investor* would send out thousands of surveys to portfolio managers, directors of research, and chief investment officers of the world's largest pension funds, hedge funds, and mutual funds, asking them to rank the analysts in each industry sector based on any criteria they saw fit. *I.I.* then weighted the number of votes for each analyst according to the size of the institution, which was based on the amount of money under management.

Starting in 1972, the October issue of the magazine featured profiles, complete with pictures, of 20 or more stone-faced middle-aged guys, and eventually a few women, in suits (fortunately, there weren't centerfolds). No muscle-bound, in-their-prime 21-year-old quarterbacks to be found here; instead we learned about the top analysts in the pharmaceuticals sector or the steel industry.

Here, finally, was a way to measure the performance of individual analysts. The banks loved it. The All-America Research Team became a huge hit for *Institutional Investor*. Gil Kaplan had a moneymaking franchise on his hands.

By the time I got to Wall Street, the rankings had become the most accepted way to value an analyst's contribution. How accurate our stock picks were didn't matter so much. What did matter was whom the buy-side analysts and portfolio managers voted for in the poll. And so our jobs became as much about responding to the needs of every potential voter as they were about actually doing research and

accurately picking stocks.

It had taken me a while to get the hang of this *I.I.* thing. After all, I had once believed that if I could sit in my attic and pound out good analysis, I would be doing the best job I could. But by the time I was at Merrill, I was covering all of my bases. There were approximately 400 institutional money-management firms that voted, and each had at least one or two analysts focusing on telecom stocks. Each of these buy-side analysts, plus many portfolio managers at these firms, was a potential voter. It was my job, like a local pol doling out attention and sometimes favors, to make them like my work, like me, and, most of all, to like me enough to scribble my name onto that *I.I.* survey sheet.

This meant making sure I was always responsive to any question a client had about the industry, even if it meant returning phone calls from Indonesia at 4:00 AM. I'd do my best to take the initiative by calling clients whenever there was news or any new developments that could have an impact on their telecom portfolios.

Each client had a different set of priorities, which meant that if you wanted to do well, you had to figure out what made each one tick. Some voted for the name they knew best, meaning it was helpful to be quoted regularly in *The Wall Street Journal.* Others voted for the most influential analyst, the nicest guy, or the most responsive one; some clients actually kept a record of how many times each analyst called in a given quarter. And a few even voted for those whose stock picks had worked out best. It was a complicated psychological study, and it required every bit of emotional intelligence and organizational skill I possessed to remember that Bill at Janus loved to talk about skiing or that Patty at Capital Group had gotten burned buying AT&T a few years ago and was looking for a way to feel better about it.

There was really no end to the amount of work you could put into this aspect of the job, especially if you were a paranoid sort like me. I could always make just one more call, and that's what I tried to do to stay ahead. I was the hard worker after all, not the intuitive genius.

Just as for a candidate for county sheriff, face time played a big part in the care and feeding of clients. Every Sunday night, I'd sit down and go through my Rolodex to determine who I should contact that week. I organized my clients by geography. "Boston" meant Fidelity, Putnam, State Street Research, State Street Bank, Wellington, and MFS, among others. It was customary for analysts to go to Boston twice a year, so I ramped it up to three times once I learned from some of that extra survey information that *I.I.* was happy to provide—

for a fee—that I was ranked second to Jack Grubman by Boston voters.

In a typical year, I'd hit Boston three times, Chicago twice, and 27 other cities, ranging from Minneapolis to Montgomery to Portland, Oregon, to Philadelphia, once, with a day or half day in each city. I traveled to Europe at least once a year, visiting mutual funds, pension funds, and trust companies in London, Edinburgh, Amsterdam, Rotterdam, Paris, Stockholm, Frankfurt, Milan, and sometimes Dublin and Madrid, often hitting two cities per day.

Each day would begin with a breakfast meeting and go on late into the evening, with clients stacked one after another, usually one per hour. I'd give my shtick on the industry and the reasons for my recommendations, try to tailor something special for each client, and then answer any questions they might have on the industry, on stocks, on deals, or on anything.

With some folks, the call was almost totally social. We knew and liked each other, and if they wanted to talk about skiing or music or politics or the weather, that was fine by me. It added spice to an otherwise highly repetitive life. With others, it was all business from the moment I walked into their office. All of these buy-side analysts and money managers received our research, but they got everyone else's research too. So it was this personal touch combined with my investment ideas that I hoped would win me votes.

I also invited clients to special events, meetings with company executives, and anything else that I thought might interest them. I regularly hosted lunches with telecom executives at the St. Regis Hotel for about 20 carefully selected clients who might truly appreciate getting to know the CEO of Verizon, say, or were particularly interested in the viewpoints of the chairman of the Federal Communications Commission.

For five years running, I organized ski trips for buy-side clients to Vail, Telluride, Park City, Snowbird, and Whistler. Everyone had to pay their own way—this wasn't a freebie from Merrill—but it was a great opportunity not only to have fun but also to debate the key issues facing telecom investors.

I came to really like this part of my job, although it was exhausting. I had to be "on" all the time. Every move I made, every quote in the paper, every bad joke, could end up as a reason to vote for me or against me. It sounds absurd, and it was. Yet ultimately this

ranking made a huge difference to both my career and my firm.

So in late 1995, shortly after I had upgraded the Bells and downgraded AT&T, I was traveling when I got the word that it finally happened. I'd snagged the number-one rating in wireline services, achieving the goal I'd set when I came to Merrill. Of course, this also meant I'd unseated Jack. I was proud as hell, thrilled for my team because I thought I would likely be able to get them bigger raises now, and at the same time, scared: having made it meant that all of my competitors, especially Jack, would be gunning harder for me the next time. This was no time to coast.

My making it to number one coincided with Merrill's becoming the number one research department, with the highest number of ranked analysts of all the Wall Street firms. On December 8 of that year, Merrill held a special lunch, inviting each analyst who was ranked as a runner-up or higher.

The lunch was held in Merrill's executive dining room, and 12 or so tables were set up, each one pairing a few analysts with a senior executive or two. I was seated with "Danny Boy" Tully, proving, I guess, that the firm actually did hold telecom in high regard. Eventually, Tully and a few other Merrill executives made speeches that thanked and congratulated us. Getting ranked in *I.I.,* they said, was good for everyone. It made it easier for the retail brokers to attract clients, helped the traders and institutional sales people generate more commissions, and, lest we forget, it helped the bankers attract investment banking business from corporate executives.

"Just to Make Things Interesting"

As the Telecom Act headed toward President Clinton's desk, every analyst meeting or company visit took on added importance. A huge merger wave seemed poised to wash over the telecom industry, and we were ravenous for clues as to who was going to swallow whom. Although LDDS was still certainly a "second tier" long distance company, it had clearly emerged as the most interesting—not to mention the biggest—of that group in the past year.

This was mostly because of its high-flying stock and the fact that LDDS had made two major acquisitions: IDB WorldCom, bought out of near-bankruptcy after the follies of its executives, and WilTel, the national fiber-optic long distance network, which it bought for $2.5 billion in a Salomon-advised deal. It had also picked up its new name, LDDS WorldCom, meant to better evoke the company's global

ambitions.

On January 31, 1996, I attended an analyst meeting hosted by LDDS WorldCom at the New York Hilton. The meeting was uneventful and I learned little, at least not until I was leaving the hotel. As I was walking to the escalators, Jack Grubman came up alongside me and we ended up walking out together.

"Hey," he grunted, ever the tough guy. "How ya doin'?"

"Fine, Jack, you?" was my minimalist response.

"Good," Jack answered. "So I guess we're on opposite sides of this Baby Bell versus long distance argument, huh?" he said.

"Certainly looks like it," I acknowledged. Damn straight we were. He had just issued a 115-page report arguing virtually the exact opposite of the opinion I had issued six months earlier. Any analyst (read: me) who thought the Baby Bells were going anywhere, he wrote, was "starry eyed," "bull-headed," and "nuts."

"Well, you know, Dan," Jack blurted suddenly, "if you hadn't reversed [your opinion], I probably would have—just to make things interesting."

I looked around to see if anyone else had heard this. Here was a top-ranked telecom analyst, one with a huge following among both institutions and individuals, telling me—his chief rival—that he would have changed his opinion "to make things interesting"? I thought I heard the music from *The Twilight Zone* playing in my ears. He'd had a completely straight face. Was he joking, or did he actually mean that? I didn't know what to say, so I said nothing. Fortunately, we had reached the Hilton's exit and we parted ways.

As I jumped into a cab to head downtown to my office, I pondered the role of an analyst. Wasn't I supposed to recommend stocks that my analysis suggests will go up and not recommend those that it suggests will go down? So what job was Jack doing? Would he change his opinion for the sake of its entertainment value?

"Now I get it," I said to myself. "Jack's in the entertainment business and I'm in the stock-picking business." He didn't have it all wrong, actually. The way we conveyed our opinions was important, as I'd learned, and we both spent a lot of our time entertaining people and trying to make them like us. But even to joke about this stuff was,

in my mind, the antithesis of funny. We were just so different.

That difference in itself was entertaining, it turned out. The clients and companies we worked with were well aware of our evident mutual dislike, and eventually, Mark Landler, a reporter from *The New York Times,* decided it deserved a story.

The result, "The Siskel and Ebert of Telecom Investing," appeared on the front page of the *Times*' Sunday business section on February 4, 1996, complete with "Picks and Pans from Jack and Dan" and photos. I refused to pose with Jack, a fact Landler made a point of mentioning in the story. I suppose the piece was good publicity for both of us, although neither of us could resist a few digs at the other.[6]

I said Jack was "intuitive and gut-oriented." When pressed on how Jack and I were different, I deadpanned "Before making conclusions, I try to do the work."

Jack's response was both funny and true: "I bet you that in college, Dan was prepared for every test, while I was cramming at the last minute," he said.

The story went on to discuss why Jack favored the long distance companies like AT&T and MCI and why I liked the Bells. Then Jack said something that, in retrospect, sounds pretty prescient, though in an odd way. Alluding to his view—an absurd one in my opinion—that the Bells would never meet my forecasts unless they violated the legal requirements of the Telecom Act, he boldly asserted, "If you believe Dan on the ability of the Bells to collude and conspire, the CEOs of these companies will all be sharing a cell at Leavenworth in five years." He sure was right about CEOs going to jail, but wrong about which ones.

* Telecom users, especially large corporations, would be able to significantly lower their communications expenses if they could use a local provider other than a Baby Bell. Even more important, long distance companies such as AT&T and MCI wanted to connect directly to customers via these new companies, thereby bypassing the more expensive monopoly networks of the Baby Bells.

4. INTIMIDATION

1996–1997

For some of the people in my world, intimidation was simply part of doing business. It was natural, I suppose, in a world that was entirely transactional: if you do x, I'll do y. If you don't, you're screwed unless you have enough power to resist the arm-twisting. I'd mostly managed to avoid this stuff—until now.

M&A Mania

MY RIVALRY with Jack Grubman had existed since my MCI days, but my reversal on the Baby Bells had taken it to a whole new level. Now, as 1996 dawned, it would ratchet up a few more notches as we came down on the opposite side of almost every new strategic move announced in our industry. We spent this year locked in combat, going head-to-head not only on several major deals but also on what we believed was the appropriate role of an analyst.

In part, that was because there were so many new deals to disagree about. The Telecom Act of 1996 launched one of the biggest merger and initial public offering (IPO) waves in history. President Clinton signed it on February 8, in a midday ceremony at the Library of Congress. Al Gore, claiming credit for his "information superhighway" legislation, was present, as was Reed Hundt, Gore's high school buddy and chairman of the Federal Communications Commission.

Over the next four years, seven of the nation's eight largest local phone companies, the Baby Bells, would enter into multibillion-dollar mergers, mostly with each other. The major long distance companies would scramble to find a way to offer local service, with both WorldCom and AT&T paying huge premiums for startup competitive local carriers such as MFS and Teleport. Even MCI would be gobbled up in dramatic fashion. And with the emergence of the Internet as a transformative communication tool, new long distance companies

such as Qwest and Global Crossing emerged, offering "broadband," or high-speed data transmission services. The numbers were mind-boggling and the pace was staggering.

More deals, of course, meant more multimillion-dollar fees for bankers. Yet this deal frenzy wasn't just about M&A, nor was it only about the Bells versus the long distance incumbents. It was also the beginning of the IPO boom, in part because the new entrants in the telecom field desperately needed capital to compete against the fat incumbents.

On April 1, I awoke to the news that Southwestern Bell (SBC), based in Texas, was buying Pacific Telesis, another Baby Bell based in San Francisco, in a $16.7 billion deal. It was a smart move for SBC, in my view, but one that came as a huge surprise to most industry observers. I had not expected this particular combination, but I had been predicting Bell mergers, including the $23 billion combination of Bell Atlantic, based in Philadelphia, and New York-based NYNEX, which came three weeks later, on April 22.

I wasn't brought over the Wall in either case. Merrill's bankers, led by my colleague Tom Middleton, were advising Bell Atlantic and snagged a huge $30 million fee. I was informed of the Bell Atlantic–NYNEX deal the night before its official announcement, because Merrill's compliance lawyers wanted to make sure I knew I would be restricted from commenting on the deal and should remain silent in the morning. I viewed both mergers positively, for both the cost savings and the greatly expanded geographic coverage it would give the merged companies. I thought they were doubling their bets on something good. Not surprisingly, Jack's view was the exact opposite: that the Bells were putting all of their chips on something bad.

Nothing Personal?

But Jack and I didn't disagree on absolutely everything—or so I thought. We were both bullish on the new startup local phone carriers, companies that were building local phone networks to compete with the formerly monopolistic Baby Bells. The two largest of these startups were the Jim Crowe–founded MFS, which had been the first of the group to have an initial public offering back in 1993, and Teleport Communications. Salomon had handled MFS's IPO before Jack came to the firm.

Now, in June of 1996, Teleport wanted to go public. Although I firmly believed that the Bells had the advantage over the long distance

companies, I believed just as firmly that these startup local carriers were a good investment story. With their fiber-optic cables, they offered the only possible alternative for the long distance companies wanting to bypass the Bells' local monopoly. Either AT&T, MCI, and the others would be the startups' natural customers or, desperate to reduce their dependence on the Bells, they'd buy them up—hopefully at big premiums. My colleague Mark Kastan and I had been recommending MFS shares since January, having titled our initial report "MFS: Desperately Sought Assets" on the theory that it was a good acquisition candidate.

Merrill was handling the Teleport IPO largely because, seeking a cheaper telecom option, it had been one of the company's founders and had been one of its largest customers. So it was Mark Kastan's and my job to come up with an estimate of the price the public markets would pay for the company. This was much tougher than making such a prediction for an already publicly traded company. Teleport's history was much shorter, and there were few similar public companies to which it could be compared. Indeed, MFS was the only similar company. If I had been analyzing Bell Atlantic or SBC or GTE, by contrast, I would have had a huge base of information to start with and, of course, a long history of how its price-to-earnings ratio and other valuation measures compared with those of other companies.

Just when the Teleport IPO road show was set to begin, MFS and its banker, Salomon, suddenly announced that MFS would soon be selling an additional $1.17 billion of stock to the public in what is known as a secondary offering. The announcement was unusual because it meant that both Teleport and MFS were coming to the capital markets at the same time and competing for investors' attention and dollars. Since MFS shares were already publicly traded and the company's management was better known than Teleport's, there was a risk that Teleport's offering would be overshadowed by the MFS road show. It seemed as if MFS and Salomon were trying to undercut Teleport and Merrill by showing everyone who was boss of this new sector.

As Teleport's IPO approached, Mark and I hosted two conference calls, one to Merrill's retail brokers and one to several hundred institutional investors. Somehow, Jack managed to hear one of our conference calls, and he went bonkers. Was it personal? Or was it just Jack being his intensely competitive self? I didn't know. Whatever the reason, Jack was so agitated when he heard what we were saying that he apparently decided to violate the rules of both his own bank and the Securities and Exchange Commission. At Salomon—and at all

investment banks—all research reports had to be reviewed by an internal compliance department before being sent to clients, to make sure that analysts had a reasonable basis for recommendations and also to keep them from inadvertently publishing confidential information about a banking client.

The SEC's regulations at the time stated that a research analyst could not write about a company if his firm was in the process of underwriting a stock offering for that company. This was to prevent the underwriting firm from "conditioning" or hyping the market in advance of an offering.

Nevertheless, on June 18, 1996, Jack faxed a two-page report to hundreds of his clients, titled "Merrill Commentary on Teleport/MFS Comparison Flawed." It was 13 days before the MFS offering and 9 days before the Teleport IPO, a time during which he was supposed to be restricted from writing reports on MFS. Someone faxed it to the CFO of Teleport, who faxed it on to me.

I blanched when I read some of this report. It sure seemed as if it was conditioning the market with its bullish comments on MFS. And the personal venom really got me. The first sentence read: "Merrill Lynch (lead manager of Teleport IPO) held a conference call yesterday where they attempted to justify Teleport vs. MFS by putting forth typically stupid arguments." The next paragraph was subtitled "Rebutting Merrill's ridiculous arguments of yesterday." It read: "It is no wonder that our auto analyst returned from Merrill after a couple days given the lack of intellectual honesty put forth by them vis-à-vis MFS and Teleport."[1]

Okay, I thought, this guy has really hit the skids. Jack was referring to the fact that a few days earlier, Merrill had hired an analyst from Salomon who decided that he didn't want to stay, as happens occasionally. Sometimes analysts just didn't feel comfortable in their new culture and quickly hightailed it back home, often scoring another raise in the process. What did this have to do with the opinion of a telecom analyst on Teleport? Well, maybe you would have had to take a *Being John Malkovich*–type journey into the folds of Jack Grubman's brain to find a connection.

That was weird, all right. But the real issue was that Jack had apparently sent out a report that could boost MFS's stock price—in effect, conditioning the market in violation of SEC regulations. I didn't really mind; I knew our analysis of Teleport and MFS was not "stupid." I figured Jack's emotional outburst could only hurt him with

our mutual clients. Jack's attacks also brought me more attention from the buy-side. But I did send a copy to Andy Melnick, the head of research at Merrill, who apparently passed it on to Herb Allison, who ran Merrill's investment banking business and would soon become Merrill's president. About a week later, I was told that Herb had called his counterpart at Salomon, Deryck Maughan, to complain.

I later heard from a few clients that the Salomon compliance department had contacted them as part of an investigation into the report. They were asked when and how they received this fax. Apparently, Jack's report had not been approved by compliance. It sure looked as if Jack was finally about to get what was coming to him.

But if Jack received a reprimand of some sort, it was never apparent. He simply continued on his merry way, interpreting his job as he saw fit. And it appeared to me that Salomon condoned it or, at the least, ignored it, thereby reinforcing his behavior. Whether or not he was using not-yet-public information prior to Frontier's acquisition of ALC, or whether he was bypassing a compliance review or simply making unsupported, outlandish accusations, he pushed the line, was rewarded for it, and did it again, each time advancing just a little bit further. Worst of all, I thought, he was establishing a model that many younger analysts would try to follow in the months and years to come.

Despite Jack's interference, Teleport's IPO was a big success. The initial price of the stock was $16, and it closed at $17.63 at the end of the first day. Within three months of the offering, Teleport's stock price had risen 34 percent, to $23.63. MFS, too, succeeded in its offering, raising over $1 billion.

About a month after this incident, I got the news that I had landed the top spot in *I.I.* for the second year in a row, with Jack coming in second again. I was relieved, more than anything. The only thing harder than making number one was staying number one.

Internet Ignorance

As the deals kept coming, one after the other, I felt like a tennis player facing Pete Sampras. The best I could hope for was to return the serve and buy enough time to get in place for the next one. The next month, on August 26, 1996, WorldCom shocked the Street when it announced that it was buying MFS, Teleport's competitor and Jack's favorite startup local carrier, for $14.4 billion or $55 a share, a 23 percent premium over MFS's trading price. This was good news for Mark and

me and better news for Jack. We'd all been recommending MFS shares, so investors who followed our advice made lots of money. But the buyer *and* the seller, WorldCom and MFS, were both Salomon clients, not to mention Jack's favorite two companies at the time. It appeared to many that Jack, like the Wizard of Oz, had orchestrated this deal. And Jack, with his smug insinuations, played this new part to the hilt.

Jack had an increasingly powerful ally and friend in the form of Bernie Ebbers, the CEO of WorldCom. WorldCom now did almost all of its business with Salomon Brothers, thanks in large part to Bernie's favorite analyst. As the 1990s went on, Jack and Bernie came to be thought of in the same breath. WorldCom's mushrooming growth and soaring stock price made Jack look increasingly brilliant, while Jack's growing influence, combined with his constant touting of WorldCom's stock, made Bernie look equally astute. The two were becoming close friends as well. Bernie was Jack's starmaker and Jack was Bernie's.

Despite our frustration over Jack's triumph, Mark and I thought the deal made tremendous strategic sense. And it fit in perfectly with our earlier prediction that the long distance companies desperately needed to build or buy local infrastructure. Nevertheless, we thought WorldCom was paying a very steep price, so we repeated our cautious stance and Neutral rating on WorldCom shares.

We estimated the acquisition would reduce WorldCom's earnings per share by 87 percent, from $1.24 to just 17 cents, because MFS, as a startup, was losing massive amounts of money. Investors seemed to agree: WorldCom's shares fell 16 percent the day of the acquisition announcement, while MFS shares jumped 28 percent that same day to approach the price WorldCom had offered for the company.

I wanted to know more about the pricing of the deal. So two days later, Mark and I met with Jim Crowe, MFS's CEO and founder. A former executive at the privately held Omaha construction firm Peter Kiewit & Sons, Crowe had astutely pushed Kiewit into telecom as a logical outgrowth of its construction capabilities. After all, building a startup local carrier was basically one huge construction job: digging up city streets, pulling fiber through sewer conduits, drilling holes through foundation walls, and constructing power rooms to house telecommunications equipment.

Jim Crowe had the appearance and deep, booming voice of a marine drill sergeant. A fit guy in his mid-forties, he stood about six

feet two and wore a flattop that made him look like a frowning Herman Munster. He was completely obsessed with his company and an indefatigable evangelist for it. This didn't mean he was a schmoozer type, however. No, a meeting with Jim Crowe was like a meeting with the school nerd who'd been born again. He'd come at you again, and again, and again, not with words and jokes, but with numbers. He never smiled, never laughed, and he had what seemed like a compulsive need to quantify everything, a trait that he and I shared. One might have thought Jim and I would have gotten along famously. We didn't.

Crowe didn't much feel like talking about the deal. He was onto something new and important. Yet I was so obsessed with understanding the high price WorldCom had paid that I missed it entirely. He called it "IP," or Internet protocol, the new technology by which Internet information would flow through the world's communications networks. Crowe's notion was that the Internet was going to change the world, and that MFS and WorldCom would transmit much of the world's Internet traffic. Just prior to WorldCom's offer, MFS had quietly acquired a small, relatively unknown company called UUNet (pronounced "you you net") for $2 billion. UUNet was the country's largest "Internet service provider" and was growing like wildfire.

I was mystified. Although telecommunications and the Internet would later become as linked as Siamese twins, I didn't quite see the connection between the two. I made a mental note to someday figure out exactly what he was talking about. Most people credit Mary Meeker with first educating Wall Street about the Internet. I sat next to Mary Meeker at Morgan Stanley for several years, but she hadn't yet discovered it when I departed for Merrill Lynch in early 1993. So, for me, Jim Crowe was the person who first alerted me to the Internet's potential impact on the telecom industry. But at the time, I was more concerned with surviving the next deal announcement and fending off Jack's attacks than I was with the largest technological shift of the past several decades.

Suffocation

As my eighth year on Wall Street began, I reflected on the complexities and pressures of my job, which seemed to be mounting every day. Originally, most of the incentive to perform came from me. I'd achieved my goal of becoming the top-ranked analyst, but the stresses were building from just about everywhere else.

There were the bankers wanting bullish opinions on their client companies and the institutional investors wanting the price of their stock holdings to go up. There were the hedge funds, many of which bet against certain stocks, hoping for negative calls from analysts. There were the in-house traders and retail brokers pushing for coverage of volatile small stocks and for calls that made stocks rise or fall and therefore generated lots of commission-generating trades.

And then there were the pressures from the company executives themselves. A CEO or CFO wants positive commentary from well-known opinion leaders. As I had learned years earlier from Bert Roberts at MCI, positive reports can help to build customer confidence and thus help sales efforts. The resulting higher stock price can also help to fend off unwanted takeover attempts, preserving management's job security and boosting employee morale. But that wasn't supposed to be part of my job.

I had been lucky so far. I had never felt that my views, even when unpopular, had been impugned or threatened. Back in 1994, when I refused MCI's CFO Doug Maine's request to testify against the expensing of stock options, I never heard about it again. And, in November of that year, when he complained about the tone of my downgrade of MCI shares, he didn't do anything other than ask that in the future I give him advance notice of a pending opinion change, something I had no intention of doing. The worst thing that had happened was that MCI's CEO, Bert Roberts, canceled his appearance as a keynote speaker at my annual conference. And that wasn't so terrible after all.

But such freedom wouldn't last much longer, as a lighthearted interchange I had with a speaker at one of my annual conferences foretold. In March 1995, I had asked Bernie Ebbers, CEO of what was then still called LDDS, to speak at Merrill Lynch's Fourth Global Telecom CEO Conference—an annual gathering I organized at Manhattan's posh St. Regis Hotel. His was one of the fastest-growing telecom companies, and I was pleased to have him on the podium with me, even though we were not recommending his stock at the time.

Bernie was the second speaker of the morning, and I introduced him with the typical kissup: "Bernie's done absolutely amazing things. He started the company as a very, very small reseller, and through the process of acquisition and internal growth has moved the company to be…half the size of Sprint. Bernie, we're all very anxious to hear about your next steps and the future of LDDS and your perspective on

the industry and how the merger's going."

The applause was enthusiastic as Bernie, boots and all, swaggered his way to the podium.

"Thank you, Dan. Can I not use this stool here?"

Yeah, yeah, yeah. This was the requisite dig at my height. He was tall; I was short. Some people laughed. I guess it could have been worse.

Bernie next made what seemed like another joke, though it was always tough to tell with him. Before beginning his speech, he coyly alluded to an acquisition he had agreed to over breakfast that morning. Figuring that if it had been done that morning, it must have been at the St. Regis, possibly with Merrill's bankers brokering the deal, I interjected with a smile:

"So did Merrill Lynch arrange that deal?" I asked jokingly.

"No," snapped Bernie. "We have to have a better rating before Merrill Lynch would do the investment banking."

A lot of nervous laughter followed. Mark Kastan, who still rated Bernie's company Neutral, chimed in, "I guess you'll be waiting a long time!" I laughed, too, but hollowly. Bernie wasn't one to mince words. He simply said aloud what others thought to themselves.

IF THERE WAS ONE WATERSHED YEAR for the telecom business—and the analyst—it was definitely 1997. The M&A frenzy was at full throttle. The IPO wave was also gaining momentum, as numerous telecom upstarts and technology startups began to raise capital in the public markets. And the bull market was now in its third year, having totally ignored Alan Greenspan's "irrational exuberance" speech of December 5, 1996. Investment bankers trampled each other in pursuit of fees. Companies sought to maximize their stock prices, both to enrich their executives and also to build a currency with which to buy other companies. More and more investors, individual and institutional, dove into the market headfirst.

To keep the party going, all eyes looked to the Wall Street analyst. The media salivated over us and glorified our market influence and stardom, even when hinting at analyst conflicts of interest. "More important, at many firms, is how much investment banking business

an analyst brings in…. Also important at some firms is the trading volume the firm does in the stocks an analyst covers," *The Wall Street Journal* had noted as early as June 1994.[2]

And, in an early 1997 *Journal* article entitled, "For Salomon, Grubman Is the Big Rainmaker," a reporter wrote: "This dual role [of analyst and banker] obviously is fraught with complications and potential conflicts." William McLucas, the SEC's enforcement chief at the time, was quoted in the article, saying, "There are no hard and fast federal laws that say you can do this and you can't do this."[3] Without realizing it, McLucas had suggested not only that the SEC, ostensibly protecting the integrity of our financial markets, was aware of the conflicts but also seemed to knowingly look the other way.

Those same newspapers and magazines consistently relied on analysts when discussing stocks. Those stories spread quickly as the new breed of online day traders lunged at every bit of news and spread it across the Internet. The advent of CNBC, the business cable network created by NBC in affiliation with Dow Jones, also boosted the visibility of many analysts.

CNBC, launched in 1989, was originally supposed to be a niche play, but as the bull market grew and the public developed a love affair with stocks, the cable channel's viewership also grew. Whenever a company issued an earnings report or announced a merger, a top-rated analyst would be on-air within the hour, eagerly giving his or her opinion on what it all meant.

This new exposure only cemented the preeminence of the analyst. In the 1980s, powerful traders and investment bankers came to be known as BSDs—Big Swinging Dicks. Now, by the mid-1990s, the BSDs were the analysts—the nerds with the power of the pen and the pager and the ability to make and lose fortunes with a change in opinion or tone. Institutions, whether they actually took our advice or not, hounded us for insights and advance notice of coming events; and bankers and CEOs, of course, still cared passionately about what we had to say. It was easy to feel like a rock star—that is, if you stuck to your own world and didn't actually try to hang out with any real ones.

Sure, it was fun to issue a report that actually moved the markets or to be involved in the back room of a multibillion-dollar deal. But what was less fun was this slow sense of suffocation as the pressure grew from all the various players in the business to conform, to help the bankers, to not rock the boat, to favor companies that might offer

up a top underwriting or merger-advisory slot. Sometimes, it took the form of subtle needling; other times, it was more direct and intense. For some of the people in my world, intimidation was simply part of doing business. It was natural, I suppose, in a world that was entirely transactional: If you do x, I'll do y. If you don't, you're screwed unless you have enough power to resist the arm-twisting. I'd mostly managed to avoid this stuff—until now.

My Failed Quest for Qwest

It was January 6, 1997, my first day back after a two-week vacation with my family in Andalucía, Spain. Had I known what was coming, I probably would have tried to hide out on those Spanish beaches. I had been invited to attend a Merrill breakfast meeting with executives from the Anschutz Corporation, the private investment vehicle of billionaire Phil Anschutz, who had made a fortune in oil and railroads and had owned Southern Pacific Railroad. Brilliantly, Anschutz realized that Southern Pacific's rights of way along its railroad tracks were needed by long distance companies seeking to build fiber across the U.S. When he sold off his railroad interests, he cleverly retained the rights of way and started his own long distance company, SP Telecom, which he was about to rename Qwest Communications.

Now Phil wanted to cash in by selling a piece of Qwest to the public. Merrill, like every other investment bank on the Street, was drooling over the potential fees involved. I expected the meeting to be the usual meet-and-greet with little or no substance: lots of smiles, animated discussions of golf courses, and, at the end, a bunch of warm handshakes, as both sides committed to work toward a stronger relationship.

Both sides had a major interest in such a "relationship." For the firm, of course, the goal was to earn a percentage of any of the client's financial transactions, even beyond the coming IPO. For the company, there were multiple objectives. One was to have as many friends on Wall Street as possible, so that it could raise capital smoothly and quickly through a variety of underwriters. In addition, a good relationship with a good bank might mean an early warning when an attractive company went on the block. And Merrill was a huge user of telecommunications, so companies were constantly trying to sell telecom services to Merrill, hinting that it might lead to investment banking assignments. Last but certainly not least, the bank's analyst could help the company achieve a higher stock price.

Qwest did not yet have publicly traded shares, so I hadn't written

any reports or issued any opinions, though I had mentioned it in some of my reports. As a new long distance company with no dependence on the antiquated technologies or costly unions that saddled AT&T and the others, Qwest's cost to provide long distance capacity looked dramatically lower than that of both the Bells and the other long distance companies. It was the JetBlue of the telecom world. I also thought that a Baby Bell might buy Qwest at some point. Yet I had doubts, too: I continued to worry about excess capacity and price wars in the long distance industry. So my feeling about Qwest was positive, but not roof-on-fire enthusiastic.

But that was not going to work for the folks at the Anschutz Corporation, although I didn't know that as I ushered Joe Nacchio, Qwest's new CEO, and a man named Cy Harvey into a private dining room on the 33rd floor of Merrill's world headquarters. Phil Anschutz, also Qwest's chairman, didn't show. The view from Merrill's top floor was stupendous, overlooking huge yachts docking, the Ellis Island ferry shuttling tourists to their grandparents' first memories of America, and the beautiful Miss Liberty. Though thirteen floors higher, it was essentially the same view I had from my office, and a pretty inspiring way to start the day.

I always felt uncomfortable in this type of meeting, mostly because I was never good at the kind of mutual backslapping and schmoozing that went along with this part of the job. At the time, I didn't play much golf and didn't hunt pheasant, which seemed to be a favorite activity of CEOs and bankers. I didn't have a whole lot of interest in trudging through a muddy field, trying to kill some animal happily nibbling some grass or a bird enjoying a morning whirl. To these gun-toting tough guys, I was a nerd. And that was, I realized, a perfectly acceptable role for an analyst to play, a lot easier to pull off than walking around in camouflage and faking it. It worked great with almost everyone I interacted with, but not so well in these deliberately shallow meetings.

Attending the meeting from Merrill was Tom Middleton, Merrill's head of telecom banking, Mark Vander Ploeg, the Merrill banker assigned to work with the Anschutz Corporation, Mark Kastan, and me. Because Qwest had the potential to become a major profit center for Merrill, Herb Allison, Merrill's president, was there, too, playing the role of senior statesman. A bald, brainy, serious man who chose his words carefully, I hadn't interacted with Herb much, but we were all happy to see him. His presence would likely demonstrate to Cy and Joe how committed Merrill was to serving Qwest.

Joe Nacchio was the most convincing and combative executive I had ever met. Joe and I had tangled before, when he was president of consumer long-distance services at AT&T. He was opinionated, extremely aggressive, sometimes quite funny, and even charming when he wanted to be. By force of—or perhaps, despite—his abrasive personality, Joe had managed to climb his way up the ladder at AT&T, where he had spent his entire career before Phil Anschutz hired him away just weeks earlier. With his long years of experience at AT&T, Joe seemed a great fit, and his hiring seemed to create the perfect time to sell a portion of Qwest to the public in an IPO.

Joe was uncharacteristically quiet. I suppose he was trying to act gracious and authoritative, as he'd seen other chief executives act in the past. Or perhaps he knew what was coming.

He deferred to Cy Harvey, who was president of the Anschutz Corporation and, at least for today, was the designated stand-in for Phil Anschutz. A round, quiet man who had seemed rather gentle until this point, Cy didn't waste any time by describing his latest elk hunt. Instead, he sat down and immediately launched into a diatribe against a very stunned analyst—me. He explained that he had just read my most recent report, in which I argued that the long distance industry was headed for an increasingly competitive period given the entry of the Bell companies and low-cost startups like Qwest. I had, indeed, written this; it was, and had been, my basic position for the past few years. At risk, I believed, were the incumbent long-distance players, not the startups or the Bells. But Cy failed to see the distinction. He thought I was bearish on the long distance market and, by extension, on Qwest.

"I don't understand how Merrill could be a lead underwriter [of the coming Qwest IPO] with a research opinion that is so negative on long distance," he said menacingly. I stopped eating my muffin, mid-bite, and swallowed anxiously. What the hell was going on here? I sneaked a look around the table to see Middleton and Allison equally frozen, smiling thinly, forks in air. A guy we'd never heard of named Cy Harvey was telling us that Merrill wouldn't—and shouldn't—underwrite Qwest's IPO because of my research opinions. Not only was this a breach of social decorum—these "meet and greets" were supposed to be *light*—but it was a naked attempt to corner me, or at least intimidate me. And the irony was that I was actually bullish on Qwest.

I tried to look unruffled as I planned my response. I looked over at Allison, who, although normally pretty hard to faze, seemed startled. I

hoped this was no big deal for a former naval officer. I had never had a run-in with Allison about my research or opinions, even though there had likely been many complaints from AT&T and MCI, two of telecom's largest fee generators. Tom Middleton, the banker, and I had a mutual respect for each other, so I felt that I'd have some backup there, though he certainly wouldn't have complained if I suddenly turned into a screaming bull on all the companies that needed banking help.

I waited for Cy to finally stop haranguing me, and when he took a breath, I jumped in. I told him, as calmly as I could, that my report was about AT&T, MCI, and Sprint—the incumbent long-distance companies—and that I thought the Baby Bells were, as a result of the Telecom Act, going to take considerable market share from them. But to do so, the Bells would need to lease or buy long distance capacity from other companies such as Qwest. "That would be very good for Qwest," I said. Cy didn't seem to register what I had said.

Middleton, trying to defuse things, suggested that we set up a meeting with Joe and Qwest's CFO, Robert Woodruff, to develop some models. This was a normal course of action for an analyst: dig in deeply and work up a range of valuation possibilities and an estimate of what price the market might pay for the IPO. This was a guessing game, affected by macroeconomic events, industry trends, investor psychology, and a million other factors, but ultimately we all had to make a call. I said my final view on Qwest would come after my team and I had completed our forecasting and valuation analysis, which likely would take a month or two. I promised to dig deeply into Qwest's business plans and its financials.

But Cy would have none of it. He repeated himself a few more times, hammering the point home just in case we'd missed it (we hadn't): How could Merrill expect to underwrite the offering when its research analyst was so negative? (Believe me, Merrill didn't expect to win the deal by this point.) I wondered if Salomon had lobbied for the banking by contrasting Jack's more bullish reports with mine. Another explanation that crossed my mind as I sat there was that Merrill's bankers, my own colleagues, had set me up in order to cover their own asses and show Herb that the reason this IPO wouldn't be won was not because of any failure on the banking side, but because of my research opinions. Maybe I was getting a bit paranoid, but it wasn't hard with this crowd glaring at me. I took solace in the realization that I was still the top-rated analyst on that silly poll and that I still had another year left on my three-year contract.

The room was thick with tension, and everyone in the room sensed it and wanted to avoid it, even Joe Nacchio, who would normally be the first to jump into the fray. But it was one of his first days on the job, he barely knew Cy, and he probably understood that the worst thing would be to have a big bank like Merrill, with so many retail investors, as an enemy when he was personally holding millions of Qwest stock options. So he decided to try to calm the waters.

"I think Robert and I should meet with Dan and his team and explain our plans, our opportunity, and the assumptions underlying our forecasts," he said, far more calmly than the argumentative man I remembered from AT&T. "I'm sure that will help." Perfect, I thought. Bring me up the learning curve, show me why your assumptions are what they are, and I'll go back and analyze it, forecast it, put it into my strategic view of the industry, and come up with a fair valuation.

At this point, Allison chimed in for the first time, trying in his measured way to calm everyone down. "You know," he said, looking at Cy, "there are many similarities between the long distance industry and ours, investment banking. Many analysts have alleged that our business has overcapacity too. Yet investment banks' stocks have been soaring for the past several years despite the caution of many analysts." In other words, in a market like this one, it might not matter what any research analyst thought. Cy just grimaced. Whatever was up his butt wasn't going away.

Finally, the meeting ended. Mark Kastan and I went back down to our offices on the 20th floor. "Boy, did we just get ambushed or what?" I fumed. "That's pretty embarrassing to have a client attack our research in front of Herb. Who is that Cy guy anyway?"

"I don't who he is, but he must be Phil's hatchet man," Mark replied. Yeah, I thought: knows nothing, hears nothing, just delivers the final blow and moves on. The whole thing unnerved me, especially when banker Tom Middleton called me later that day to needle me a little bit.

"Quite a meeting, huh, Dan?" he chuckled. "How's it feel to be the guy that Herb Allison will remember for losing one of this year's biggest IPOs?"

The answer was that I felt incredibly pissed. Pissed because some jerk who knew next to nothing about telecom was trying to do what Bernie had joked about two years earlier: make investment banking fees contingent on bullish research opinions. Pound the table, win the

business. Simple as that. And Tom turned out to be right: in February 1997, Qwest made its selection for the lead underwriting slot for its IPO. It was…Surprise! Salomon Brothers.

Much to the chagrin of every telecom banker on the Street, Salomon and its star analyst-cum-banker, Jack Grubman, were increasingly dominating the telecom banking business. There was no joint lead underwriter on the Qwest IPO, which was tantamount to a loss for us and every other serious investment bank out there. No, the whole enchilada went to Salomon, along with the power to determine how many shares various clients got, called allocation. Merrill and everyone else were relegated to a co-manager role, which meant nothing other than that we'd all be thrown a very cheap bone to be sure some shares went through each of our firms. I was hardly surprised.

Fido Loves WorldCom

Despite the Qwest debacle, I was feeling quite pleased with the way the industry was shaking out. The Bells were advancing and AT&T was struggling, as I had predicted; many of the merger and acquisition deals seemed to support my arguments; and my clients seemed more than pleased with my research. But not everyone thought I was heading in the right direction, least of all when it came to WorldCom, which continued its pattern of aggressive growth and acquisitions—with Jack cheerleading all the way.

Fidelity Investments, the world's largest mutual fund manager, wasn't a big fan of mine. Or more accurately, the new telecom analyst there, Nick Thakore, wasn't. Nick was a young, very smart MBA from Wharton who a year earlier had replaced Abby Johnson as Fidelity's telecom specialist. Abby, the daughter of Fidelity's founder, Ned Johnson, became president of Fidelity Management & Research Co. in 2001 and is now worth roughly $12 billion, thanks to her dad's astute estate planning. Not bad for a former telecom analyst.

In the spring of 1997, I went to visit Thakore during one of my Boston marketing trips and found myself being ripped a new one by this 20-something man-child. Mark Kastan remained the lead analyst on WorldCom, rating it Neutral. I agreed with Mark's caution about WorldCom. Mark also felt strongly, as I did, that the Baby Bells' entry into long distance was going to hurt all the existing long distance players, including WorldCom. And, embarrassingly, neither he nor I yet understood how radically the Internet would change the dynamics of the telecom industry.

But Thakore had bought the Jack Grubman pitch, hook, line, and sinker, and told me that I had it all wrong. He parroted the lines I'd heard before: WorldCom would achieve even higher earnings and revenue growth rates than investors were expecting. Thakore was focused entirely on short-term earnings-per-share, rather than on the longer-term, industry-wide events and trends I thought would have a negative impact.

Thakore's argument was reasonable, but it was also one he had to make. That was because he—and Fidelity—had made a huge bet already on WorldCom following its acquisition of MFS. It had been a smart bet, as WorldCom shares had already risen from $18 to $25 since the MFS deal was announced. But his recommendation was, in large part, a self-fulfilling one: WorldCom continued to rise in part *because* Fidelity, the largest institutional investor in the world, had purchased so many shares. Companies like Fidelity moved the market all on their own, creating momentum that usually proved them right after the fact. Trying to mimic Fidelity's stock purchases was a good strategy, one that many individuals and companies employed, but it had a major downside: if you were still in it when "Fido" started selling, you were toast.

Thakore clearly wanted Mark and me to turn bullish on WorldCom's shares, pushing Merrill's retail customers into the stock and propelling its price further upward. That way, I thought to myself, Fidelity could sell its shares at an even higher price. But he couldn't say that. He had to argue the merits of the stock as earnestly as he could.

To be fair to Thakore, I had no way of knowing if he truly believed WorldCom shares were undervalued or if he was just bluffing. I didn't know if he saw me as the old guy who just didn't get it or as the old sage who cut through the hype. What I did know was that our difference of opinion was bad news for me; because of Fidelity's size, *I.I.* counted Thakore's vote as four times the vote of smaller institutions. This meant, in a survey in which even one or two votes can make the difference, I might be losing four votes just because of my (and Mark's) caution on Thakore's favorite stock. Although my job was to give advice to my clients, to have a strong difference of opinion with them wasn't always a winning strategy.

Irrational Exuberance

Nor was it a winning strategy to have a difference of opinion with the companies I covered. Although my research had lost Merrill the lead

manager spot for Qwest's June IPO, the fact that we had been selected as lowly co-managers meant I still needed to come up with a valuation for the stock, which was going to go public in June. I asked Megan and Mark to meet with Robert Woodruff, Qwest's CFO, and to dig deeply into the numbers.

On March 27, we had another meeting with Joe Nacchio and Cy Harvey, but this time, the tone was altogether different. All smiles, Joe led the discussion, telling us all about his latest hires from AT&T and offering to answer any questions we had about Qwest's plan. We interrogated him about the technology, industry pricing trends, traffic and cost trends, spending plans, key executives, and a host of other subjects. Joe was charming and as forthcoming as I'd ever seen him. Cy was quiet, looking bored. Maybe this Mr. Nice Guy stuff was no fun for him.

But the charm offensive would melt away as soon as they heard the numbers I'd come up with. By April 2, after a five-day marathon of creating different scenarios and models for the company, using a variety of assumptions, Mark and Megan came to me with a preliminary valuation for the company that averaged all of their scenarios: $1.5 billion. After reviewing their work and adjusting some of the variables, I was comfortable with their conclusions. We told Tom Middleton, who in turn, told Bob Woodruff and Cy Harvey. It turned out that our number was much lower than the valuation the Anschutz folks had modeled internally, $1.8 billion, and the whopping $2.2 billion Salomon had predicted. The reaction was not positive, to say the least.

I knew Qwest would try to pressure us to raise our valuation. Did they know something we didn't? Once we had come up with our model, it was typical for us, or any other analyst, to go over the assumptions with the company to make sure we hadn't missed or misinterpreted anything. This was another opportunity for the company to try to convince us that we were too conservative and that a higher valuation was in order. We expected that, and came dressed in our finest suits of skepticism.

It turned out that we had made a few mistakes. We had forgotten to include the value of some additional fiber-optic capacity that Frontier Corporation had decided to buy from Qwest. We had also overestimated the company's debt, which we quickly corrected. When we plugged the new information into our models, we arrived at a new valuation of $1.8 billion, in line with Cy Harvey and his gang but still $400 million below Jack.

This was a very large difference, given that most of us used similar models and assumptions. What was going on? Merrill banker Tom Middleton and his team looked closely at the Salomon numbers and found that Salomon had not accounted for what is called a "private-to-public" discount, which is the fact that virtually all publicly traded stocks trade 15–25 percent below their theoretical value, also known as "private market value."

Did a summer intern prepare these numbers? It seemed nuts to all of us. We also noticed that Jack's valuation model had an extremely high assumption for an arcane but important input called a terminal multiple. His was 13, much higher than our more conventional assumption of 8.5. If we plugged our assumptions on those two items into their model, Salomon's model fell to $1.88 billion—very close to our valuation. The bankers called Qwest's CFO, Robert Woodruff, and walked him through the adjustments, explaining that all three of us (Merrill, Qwest, and Salomon) had almost the same number. Hopefully, we'd avoid some of the conflict that had ruined our meet-and-greet back in January.

Silly me. Joe Nacchio and his team were fixated on Salomon's number, regardless of its methodological flaws, and consumed with maximizing the value of the IPO. So the word came down: Joe Nacchio wanted to talk to me directly and immediately. Here we go again, I thought. There was just one problem with his intimidation strategy: I wasn't going to be around to listen to it. After all, it was spring—*I.I.* campaigning season—and even Joe Nacchio wasn't going to keep me from visiting my clients.

I had just had dinner with the telecom analyst at Franklin Funds in San Mateo, California, and had hopped a flight to Portland, Oregon. As I checked in to the Heathman Hotel there at about 11:30 PM, the clerk handed me 20 pages of faxes. The first six pages were charts comparing the various Qwest valuations, followed by four pages of Mark's and Megan's analyses, then six pages of news clips and stock prices and four pages of copied phone-message slips, one of which was from Mark Vander Ploeg, a Merrill banker. It confirmed that a conference call had been set up with Joe and his CFO, Robert Woodruff, for the next morning, Thursday, April 3, at 9:30 New York time, which meant 6:30 AM in Portland.

As brutal as that sounds, the timing was intended to accommodate my schedule, which included a breakfast presentation to Portland money managers at 7:30 AM, a 9:00 AM meeting with Columbia Management, an 11:00 AM flight to Seattle for a lunch meeting, a

meeting with Bank of America at 2:00 PM, and finally a six-hour flight home, arriving after midnight. Hell of a day indeed—especially now that I would have the pleasure of beginning the day by getting reamed out by the biggest loudmouth in the telecom business. I tried in vain to get some sleep. This one was going to be a doozy.

I got up at 5:00 AM, checked my voice mails, and skimmed *The Wall Street Journal.* Then I showered and reviewed the valuation charts that Megan had prepared. I knew we weren't going to be bullied; we would only make a change if it turned out that we had overlooked something in the modeling. Then I dialed in to the conference call. Megan and Joe were already waiting.

Nacchio's voice boomed through the receiver: "Dan, you're on the call, right?"

"Yep, I'm here, Joe," I said, stifling a yawn.

Nacchio didn't waste any time. "I don't understand why you are so much lower than Jack," he bellowed. Geez, I thought to myself, it's 6:30 in the morning and I'm already getting that "Why can't you be like Jack" crap? I cleared my throat to be sure my reasonable self emerged, instead of the cranky one who just wanted to put the blankets back over my head.

"Joe," I said, "I don't know if you have seen the latest comparison sheet, but it looks like we are all circling around $1.8–1.9 billion when we apply common assumptions. Jack—or his banking folks—have been using some pretty aggressive and, frankly, indefensible assumptions."

One of the bankers then offered to walk Joe through the models, but he wouldn't have it. He was stuck on Salomon's valuation. Joe either didn't understand the methodology or didn't want to hear about it. He simply wanted the highest number possible, and once he got it from one bank, he wanted it from all of the banks. "Dan, I don't understand why you would be lower than the other analysts," he whined. "We're gonna beat all these numbers, you know."

After listening to him drone on for a while, my slow burn picked up speed. Plus I needed to get to my breakfast on time. "Look, Joe," I snapped, "we can debate this all day and all night and you can tell me I'm too conservative and I should be more like Jack. But the truth is, none of us is going to price this deal. The market is going to price it,

and that means that Fidelity, Capital Group, Alliance, and a few others are the ones you should be lobbying." In other words, it didn't ultimately matter a whit what Joe, Jack, or I thought the IPO would be worth. It mattered only what the market was willing to pay for it—and that was something that had become highly unpredictable in this bull market.

One of the bankers jumped in, trying to smooth over the rough edges I'd just created. "If the portfolio managers think we've undervalued your shares, Joe," he said, "they will place larger orders and we'll raise the IPO price to clear the market. So it may not really matter if we all agree on an exact price."

"But wait," said Joe, "there's more sizzle coming than the $1.8 billion reflects! We are soon going to announce an investment in Mexico, an expansion into the southeastern U.S., and three or four new executives. All of these should increase the value of the company." Sizzle? I had no idea what "sizzle" meant in a financial context and still don't. Joe, however, was a salesman at heart, and a salesman lives for sizzle. I excused myself, as it was time for my breakfast presentation. Nothing had been resolved.

Joe didn't get me to change my estimates, but as it turned out, he was more right than I could ever have imagined. After a three-week road show—the traveling circus in which Qwest's top executives traveled around the world, visiting institutional investors in 10 cities in the U.S. and five in Europe, to try to sell the stock—it went public on June 24, 1997, at $22.

Jack's $2.2 billion and our $1.8 billion estimates looked laughable after the first day of trading, when the stock closed at $28, valuing the company at an unbelievable $2.8 billion. We had all dramatically underestimated some things that didn't figure in to our models at all: the market's appetite for new economy telecom startups and the degree to which an association with the Internet—a big part of Qwest's road show—would propel valuations. Yet Jack, even though he had blown up his numbers with an air pump, was still closer to reality than I was. It killed me. Ultimately, Qwest would peak at $66, three years later. It didn't matter how meticulous our research was in an environment like this, I realized. The only way to get close to this new reality would be to add a line to our valuation model and label it "adjustment for 'irrational exuberance.'"

5. MERGER MANIA

JULY 1997 –JANUARY 1999

Our once-sleepy industry was suddenly looking like Barbarians at the Gate *all over again, with breathtaking hostile takeover offers fueled by a stock market that was making anything possible. In four short years, a tiny upstart company run by a former gym teacher had catapulted itself into the same league as old Ma Bell. WorldCom symbolized how the telecommunications industry had transformed itself from a snooze-inducing swampland to the glamour girl of the Street.*

The Case of the Secret Document

QWEST'S INCREDIBLE STOCK MARKET DEBUT signaled a new phase in the telecommunications world. Now, momentum began to have more impact than the good old-fashioned analysis I loved to do. It was worrisome. Were my methods outdated, or was the market beginning to act irrationally? I didn't know. In addition, the frenzied pace of anticipating and analyzing every deal to come down the information superhighway had worn me out.

So in July of 1997, Paula and I went to Italy for a long-awaited vacation. We headed to JFK as soon as our kids boarded their bus to summer camp, looking forward to eight days of wine, pasta, and—most important—serenity along the shores of Lake Como. From there, we planned a drive to Venice. It was already pouring when we arrived at the Grand Hotel Villa Serbelloni in Bellagio, formerly the country home of an aristocratic Milanese family, with a breathtaking position on the promontory jutting halfway out into the lake. And it kept pouring for three days straight. We spent most of our time sitting in the hotel lobby reading, and, at dinnertime, sprinting, umbrellas in hand, to various restaurants near the hotel.

We decided to pack up and head south. Our plan was simple: drive until we saw sunlight and cloudless skies, which happened as we

entered Tuscany. With no reservations and not much in the way of guidebooks, we found a hotel in Siena and spent a day touring there, learning about the special horse race called the Palio di Siena that happened in the main square once a year. We then drove south to Montepulciano, a beautiful walled city on a hilltop.

I did call my voice mail once a day, but there wasn't much happening, and for once in my Wall Street career, I felt completely relaxed. Eventually, we stopped at an *agriturismo,* a bed-and-breakfast on a farm. This seemed like the perfect place to unwind for a few quiet, sunny days. The guest rooms had no phones, which I figured would be a welcome change for me. I could always use the phone in the farmer's living room, which doubled as a guest bar, to check my voice mail.

The serenity lasted for about 36 hours. We had spent a day and a half playing tennis, swimming, and hiking when I checked my messages. One, marked as urgent, was from Megan reporting that MCI had just announced it was having a conference call for analysts and investors at 4:00 PM EST, which would be 10:00 PM in Italy. It was now 9:50 PM. I instinctively knew that this meant trouble for MCI. Why else would a company hastily set up a conference call just a week before it was slated to release its second-quarter earnings? As I had learned many years earlier at MCI, good news can await the earnings release, but the stock market had to be softened up for bad news. I wondered if it could have something to do with British Telecom's (BT's) deal to buy the company.

That transatlantic deal, which had been announced with great fanfare the previous November, was a $21 billion transaction, one *The Wall Street Journal* called "colossal."[1] If completed in the next few months, as widely expected, it would be the largest foreign takeover of an American company in history and the telecom industry's first cross-border merger. MCI shareholders would receive a whopping $36 per share, a 40 percent premium, making my Neutral rating look dead wrong. My relaxed state evaporated into the starry Tuscan night.

I ran back to our room to find Paula. I told her I had to deal with some MCI nonsense and would be in the bar. Quickly returning to the farmer's house, I tried to explain to him, using futile hand gestures, since I spoke no Italian, how sorry I was, but there were some big doings back in the States and I needed to use his phone for a while. He and his wife stared at me blankly. Using my AT&T calling card, I settled into a creaky wooden chair in the farmer's living room, with my pen and notebook ready, and dialed in to the conference call.

As I heard Doug Maine, MCI's CFO, being introduced, the farmer's wife turned down the living room lights, a signal that the bar was closing and it was time to go to sleep. But there was no way I was going to miss this call. The farmer came into the room and stared at me, first confused, then perturbed, as I proceeded to spend the next 45 minutes listening without saying a word and feverishly jotting notes in my notebook. I doubt he had ever seen anyone spend 45 minutes on a phone without speaking a single word. Was this some newfangled kind of American telepathy?

What Doug had to say was not good. He said that the challenges of entering the U.S. local market, a $2 billion, 20-city initiative MCI had announced in 1994, were proving to be far more difficult and expensive than anticipated. The punch line: MCI would earn in the range of $1.20 per share next year, instead of the $2.00 most of us had estimated. With one exception, this 40 percent cut in expected earnings was by far the largest cut I had seen in my 14 years in the telecom industry. I was shocked.

After Doug finished, the moderator announced that the lines were open for questions. I had plenty and I was anxious to get started. Someone had to get to the bottom of what was going on, and I figured it might as well be me. Not that that was an easy task. On calls like these, with upward of 1,000 listeners (analysts, institutional money managers, journalists, and others), those of us who were lucky enough to be allowed a question had to speak fast and get our follow-ups in before they moved on to another caller.

"Doug, it's Dan Reingold. I have a question." I had finally spoken, and my yawning farmer was visibly relieved.

"Jack, go ahead with your question," Doug said. Jack had a tendency to spout off for a while and give his spin on what we had just heard, leaving everyone on the call wondering what his question was. His spin blamed the evil Baby Bells, not MCI. Of course, Jack had a Buy rating on MCI and had looked very astute when the BT-MCI deal had been announced eight months earlier. Meanwhile, I had looked pretty bad with a Neutral rating on MCI. Unlike Jack, I had argued that the best partners for BT would be the Bells or the new startups, not an incumbent long-distance company like MCI.

"Next questioner please," the moderator announced once Doug was finished responding to Jack's non-question.

"It's Dan Reingold, I have a question," I blurted again as quickly as I could.

"Go ahead, Blake," said Doug. Blake Bath was the telecom analyst at Lehman Brothers and a former junior financial guy who worked for me at MCI for a few months before I left for Wall Street.

Damn, I thought to myself, I wonder if the overseas delay is causing me to be drowned out by the other questioners' voices or if Doug simply doesn't want to give me a chance.

Blake's question was also innocuous, perhaps intentionally. Like Jack, he, too, was a bull on MCI shares and I suppose they saw no point in making Doug and MCI look any worse than they already did. Or perhaps he was simply as stunned as I was.

When the monitor asked for questions again, I yelled, "Reingold, question, can I ask a question please?"

"Dan, it is hard to hear you, but go ahead with your question," Doug finally said.

"Thanks Doug," I responded. "I actually have several questions. First, you're cutting your forecast by 80 cents, or 40 percent. Can you split that between your long distance business and your local initiatives?" Doug seemed to be trying to spin us to believe that the entire problem was in the local business. But I knew that MCI's stock price was far more sensitive to its long distance outlook, as long distance produced 100 percent of its earnings and cash flow.

The farmer, who had been staring impatiently at me all this time, sighed again, mollified. At least this weird American understood that the purpose of a telephone was to talk as well as to listen. He was probably terrified that I would stick him with an enormous bill for this call.

Doug's answer was a study in obfuscation, designed to give the appearance of answering the question without actually doing so. I remembered his approach well from my days at MCI. I needed to know more, but hell would freeze over before they'd let me ask another question. Fortunately, there were a lot of BT shareholders on the call, and they kept hammering Doug on MCI's outlook, but without eliciting much added information.

It was obvious to everyone on the call that both BT's and MCI's shares would be hit hard in the morning, since MCI's disastrous

earnings outlook translated into a noticeable earnings hit for BT as well. BT's management suddenly looked like a bunch of bozos for believing that a struggling MCI would be its savior.

After several more questions from British investors, Doug finally admitted that somewhere around 20 to 30 cents per share, or one-third of the shortfall, would come from trouble in the long distance division. It seemed like a disclosure of minor importance, but it would turn out to be a major victory for me. To me, Doug's statement clearly contained a key piece of information, but it would somehow be ignored by virtually everyone on the U.S. side of the Atlantic Ocean—the arbitrage community, many portfolio managers, and most of my sell-side competitors.

By the time the call ended, it was 11:30 PM in rural Italy and 5:30 in New York. My poor farmer, who doubtless had to rise very early in the morning, was still yawning. But I was as wired as if I'd just downed 12 espressos. Here I was in the middle of one of the most beautiful, serene places in the world, and all I could think about was that I was cut off from the information I needed most.

What was going to happen to this deal, I wondered to myself. And how was I going to write this up and talk to my team? I had no cell phone, no wireline phone once the farmer kicked me out of his living room, no fax machine, no nothing. I was afraid to hang up and give the farmer an opening, so I just hit ##, got the AT&T USA Direct redial service, and called my voice mail, which was already full of messages from reporters, buy-siders, arbitrageurs, and Merrill's traders wanting to know what I thought of MCI's announcement.

I forwarded my messages to Megan and Mark, asking them to return the calls once we figured out our stance. Then I left a seven-minute message for them outlining my thoughts. My message to Mark and Megan went something like this: "MCI's announcement, shocking to some, makes starkly evident what we have been arguing for two years now: it is going to be extremely expensive and time-consuming for the incumbent long-distance companies to add local service. And, at the same time, pressures in the long distance business will only get worse when the Baby Bells start competing with them." As soon as I'd finished, I started another voice mail, continuing my thoughts. By the time I finished this one (14 minutes had now elapsed), I'd received several new messages from Megan and Mark responding to my first one. We were playing voice mail tag.

Mark and Megan argued that this was a disaster for MCI and that they thought the company was hiding an even worse long distance problem under the cover of problems in the local market. I agreed. The whole thing jibed with my belief that the incumbent long-distance players like AT&T, MCI, and Sprint were likely to suffer from intense price cutting in the long distance market even *before* the Bells entered the market. There were big implications for virtually every telecom stock, and Doug's comments were giving me the perfect opportunity to reiterate my point of view.

Paula and I had planned to drive to the medieval walled city of Lucca the next day, with numerous stops along the way. Since I didn't have a cell phone and I hoped to salvage a little bit of the vacation, I asked Megan and Mark to write up the report and to speak the following day on my behalf at Merrill's internal "squawk box" morning meeting for the sales force and brokers. I also asked them to speak for me on the conference call for institutional investors that was being set up.

It was now half past midnight. I went back to our room, where Paula, who'd been asleep for a while, woke up just long enough to ask what was going on. I whispered, "Those jerks at MCI have really, I mean really, messed up this time!"

The next morning, we began our drive to Lucca. We drove as quickly as possible, but Italy's roads can be slow and there are lots of interesting towns along the way, including Pisa, where we did the obligatory photo op pretending we were holding up the famous Leaning Tower of Pisa. We continued driving as trading of MCI shares was about to begin in New York. BT shares had already been trading for several hours in London. I assumed both would be down significantly on the MCI news, but I had no way of knowing. I had stupidly not rented a European cell phone and I had no way to receive faxes or e-mails.

As we drove along those winding Tuscan roads, I wondered whether the BT-MCI deal would hold up at all. From my rural perch, I didn't know how investors in the U.S. were reacting, or what BT's executives were saying. Was this news a surprise to BT too? If so, were they considering backing out of the deal entirely or trying to renegotiate its terms? Or had BT been fully aware of MCI's problems? Was BT still committed to the deal at its original price?

We arrived at the hotel at 4:15 PM to a pile of faxes, including a long list of phone messages, the MCI press release, Mark and Megan's

report, and the announcement that the conference call I was ostensibly hosting for institutional clients was set for 10:00 AM New York time, which meant it had started 15 minutes earlier. We rushed to the room.

For these calls, I would usually have prepared an outline and had time to study it a bit. But this time I was just going to wing it. I hurriedly dialed in to the Merrill conference call, where hundreds of my clients were waiting to get some answers. I had to explain to the skeptical operator that I was indeed one of the speakers, and heard Megan handing off to Chris McFadden, Merrill's London-based analyst covering European telecom companies, including BT. Chris had a Neutral rating on BT shares, largely because he, too, was concerned about the future of MCI.

It was a very tense moment. I had no idea what Megan and Mark had already said, what my competitors were saying, or whether new information had come out overnight that might have changed our point of view. I didn't even know for sure what we had said in that morning's report. When Chris finished his comments, I interjected that I had just joined the call from Italy and was available to answer questions.

The first one came from a portfolio manager at a large British pension fund who apparently owned a large slug of BT shares. "Do you guys think BT will proceed with this deal, as many sell-siders and MCI seem to be suggesting, or will the terms be renegotiated to a lower price?" It was a perfectly reasonable question and, boy, was it chock-full of information. His words suggested to me, though I couldn't be sure, that while I was sleeping, MCI executives had reassured investors the deal was going through as planned, and that, apparently, most of my competitors believed them.

Chris, Mark, and Megan all knew that I should be the one to take that question. I realized I had a split second to make the call on something I hadn't really thought through. I had not read the MCI-BT merger agreement and thus I didn't even know what rights BT had to terminate or force a renegotiation.

But sometimes even analytical types have to fly by the seat of their pants. So, sitting on the edge of the hotel bed, I blurted, "Of course this deal is getting renegotiated! MCI just cut its earnings outlook by 40 percent, and we've cut our earnings estimates from $2.00 to $1.15 a share, in part because of local entry costs, and also because of a much tougher long distance business, problems we've been forecasting

for two years [never miss a chance to toot your own horn]. I can't imagine that BT, or its shareholders, could stomach paying as much for a company with $1.15 of earnings power as one with $2.00 of earnings power." Chris picked up the logic and backed me up.

I didn't realize it, but my off-the-cuff prediction had just propelled me into a hailstorm of controversy. I had locked myself into a position that absolutely no one else supported. With our vacation coming to an end, we drove north to Milan to catch our respective flights. Paula flew home, and I began a week of prescheduled meetings with institutional investors in Milan, Zurich, Amsterdam, Edinburgh, and London. Many of the clients, especially the British, happened to be loaded up on BT shares and were extremely upset about the MCI news and the negative impact it was having on BT's stock.

As I traveled from meeting to meeting, I received numerous press calls and returned one to Richard Waters, a reporter I knew from *The Financial Times.* Talking to the media was an easy way to broadcast my point of view quickly without having to call scores of clients and salespeople.

Richard quoted me in the next day's *Financial Times,* one of the most widely read financial newspapers in the world: "A renegotiation is imperative—it's absolutely going to happen." Further, he said, I was predicting a 20 percent reduction in the price BT would pay for MCI.[2] I also received a barrage of calls from my traditional buy-side clients, as well as from a new constituency: risk arbitrage funds.

Arbitrageurs, or arbs, for short, make their money on the difference between the stock prices of companies involved in a merger. In this case, arbs had earlier bet that MCI's price of $25.13 on the day before the deal was announced would slowly rise to BT's takeout offer of $41.80 as the deal neared completion. As a hedge, they had also bet that BT's stock would fall in the same period of time, which is what usually happens to the acquirer's stock in a takeover. But now that MCI's earnings had tanked, the arbitrage bet had been called into question.

Needless to say, the arbs were completely spooked by the MCI news. If MCI's bad news led BT to pull out of the deal or to demand a lower price, the arbs would lose lots of money. Not only would their ownership position in MCI shares get killed when MCI shares tanked, but BT shares would rise, doubling their pain. It would be the opposite of what they had bet, and it would squeeze the arb community harder than anything had before.

Nothing matches the intensity of an arb whose bet on a merger is going awry. The arb guys are tough guys—smart, quick, and probing. They often are lawyers or have access to the best and most expensive legal advice in the world. Much of their work depends on understanding the fine contractual details of merger agreements.

Although it seemed totally logical to me that the deal would be renegotiated, I was nervous about my stance. Logic, I'd learned, didn't always matter when it came to the stock market or corporate decisions. Most of my clients and the arbs thought I was wrong, and they had no problem telling me so, sometimes forcefully. Merrill's retail brokers and salespeople were razzing me, too, because they were hearing from their clients that most of the "smart guys" on Wall Street (including some well-known arbs and, of course, Jack Grubman, best known for his inside connections in the telecom industry) had opposite opinions from mine.

Even my own team was beginning to get worried. None said it out loud, but I sensed they were definitely wondering if I had jumped the gun with too little information. After all, they knew I hadn't even read the merger agreement yet.

With my London meetings done, I hustled to Heathrow Airport, checking my voice mail en route using the driver's cell phone. The first call I returned was to an American reporter at the Dow Jones News Service, at that time the most widely read electronic news source in the investment world. Asked why my opinion was so different from everyone else's, I said I was puzzled too. "Those who don't see a change coming must have taken those little pink pills that I refused to take in college," I chuckled. "That stuff can come back on you years later." As we hung up, I thought to myself: *She's not going to use that quote, is she?* Of course she was.

We were stuck in London traffic. So I returned another call, this one from an investor client whom I had known for several years and respected. He was a very thoughtful and clever attorney-turned-investor who had put the arb spread on the BT-MCI deal. He had read the merger agreement several times, it seemed, and he had talked to Jack Grubman too.

This client was usually as gentlemanly as they come. But not this time. He barked into the phone, "Dan, you are wrong. Have you read the agreement? You've got to, especially the part about a confidential addendum. It says BT has no right to back out of the deal if MCI's problems stem from its attempt to enter the local market."

Uh-oh. Confidential addendum? This was the first I'd heard about any confidential addendum, and it terrified me.

"Okay, I'll look at the agreement as soon as I get home," I said, trying to remain calm but quaking inside. This guy knew his stuff, especially with regard to mergers, and he was telling me BT couldn't renege on this deal.

"But, tell me," I continued, "how do you know what's *in* the confidential document?"

"Grubman's got it. He told me," was my client's smug reply.

My frustration boiled over. Once again, Jack was claiming to have information that no one else did and using it to bolster his case.

"Get a copy of the damn document and then let's talk, okay?" I snapped. He agreed and we hung up. We talked several times over the next few weeks, but if he ever got a copy, I never heard about it.

Could Jack really have a secret document that only BT and MCI insiders had access to? Since I knew how skilled he was at getting information, his assertions made me very, very nervous. If he was right, I had made a grievous error in judgment, the merger would go through as announced, and I would look as if I had no idea what I was talking about. I hadn't done a lot of digging into the merger agreement, but when I finally got my hands on it and looked at the fine print, there was indeed a reference to some kind of confidential addendum. Yikes!

When I thought about it, however, I couldn't understand why a renegotiation clause would be kept secret. Wouldn't that be something shareholders—the company's owners—had the right to see before approving the merger? More sensible to me was that the addendum included some confidential competitive information, such as MCI's plans for local entry, which the company didn't want to get out to competitors. So even though Jack had been right about the existence of the addendum, the idea that it actually locked BT into this deal with no way out still seemed pretty unlikely to me. I also figured MCI's financial strength was weakening so much that the last thing CEO Bert Roberts wanted was to lose this deal. I thought he might be willing to take a lower price for fear of losing the deal entirely. So I stuck to my guns and told anyone who would listen that the price BT would pay for MCI would be cut by roughly 20 percent.

Once again, Jack and I were on opposite sides of an argument. But as increasingly seemed to be the case, his argument had the most believers by far. I was all alone on this one.

MCI/BT: The "BloodBath"

For the next month or so, the worried calls from investors continued to stream into my office, MCI kept insisting the BT deal would stand with no changes, and I kept insisting that it couldn't. And then, one early August morning in my New York office, I received an interesting call from two guys from BT's strategic analysis group. They told me that the executive team was holed up in a conference room at MCI headquarters in Washington, where they were reviewing MCI's new financial forecasts and trying to figure out what had gone wrong.

I asked whether they were considering renegotiating, but they wouldn't tell me. Instead, they had a lot of questions for me. This was unusual, but it wasn't unheard of. I sometimes received calls from telecom executives, asking for further elaboration on my reports or outlook. In some cases, they hoped to change my mind or glean some tidbit about a competitor. I had often been asked to make presentations to management and, in some cases, to the boards of the companies I covered. There was nothing nefarious about this, at least as long as they didn't share any nonpublic information with me.

The BT folks asked me about Qwest, and it quickly became clear to me that they knew virtually nothing about the company. This made it all the more amazing that the top executives at BT had been willing to get into bed with MCI without adequately understanding its competitors. Were they asking because they were interested in buying Qwest or because they were finally realizing how tough a market long distance was? I felt the tiniest bit of hope that maybe, just maybe, these guys were questioning their decision.

I had just written a lengthy report initiating coverage on Qwest, with an Accumulate, or "2" out of 5, rating. They asked me to fax it to their hotel. About five days later, on August 5, the BT strategy guys called again. This time, they asked me to meet with BT's CEO, Sir Peter Bonfield, and its CFO, Robert Brace, in Sir Peter's suite at the Four Seasons Hotel in Georgetown. So I flew down to D.C. and slipped into the Four Seasons around 11:00 PM.

At 10:00 the next morning, I took the elevator up to the appointed suite. I hadn't told a soul about this meeting. Certainly, Merrill's M&A bankers would have eagerly accompanied me if they had known about

it. They had been frozen out of the big fees from the BT-MCI merger and would have loved to pitch some different strategic moves to Sir Peter and Robert Brace. But the BT guys wanted this meeting kept quiet and I saw no reason to ignore their wishes. I wasn't sure what they wanted from me, so I'd prepared some handwritten notes about various options for partnering in the U.S.

As I sat in the lavishly appointed suite, I realized I had a chance to influence how this deal would end up. I believed that BT should hightail it out of Dodge, because merging with MCI could be the worst decision in its long history. The existing long distance companies were already suffering early signs of decline, and their market was about to be invaded by the Baby Bells. Sir Peter, an understated British executive with a gray beard and a slight frame, led the questioning. First, he asked what his shareholders were telling me.

"The British fund managers," I said, "who own far more BT shares than MCI shares, clearly want this deal to go away or, at the least, for you to pay a much lower price. The Americans, on the other hand, tend to hold more MCI shares than BT shares, and thus are praying the deal closes with no change in terms. And then there are the arbs," I continued, "who own very large blocks of MCI shares and have bet against BT shares, and who desperately need you to bail them out by sticking to the original price."

Sir Peter moved on. "What about the new telecom companies in the U.S. market? Are they going to amount to anything?"

"If I were going to buy a long distance company," I said, "I would much rather buy something like Qwest than MCI. Qwest will have a brand-new network, using the latest and most cost-efficient technologies, and thus will be able to offer long distance service at prices far lower than MCI, AT&T, and Sprint." I was telling them the same things I was saying to investors and anyone else who would listen—that buying MCI would be a bad move. "Further," I continued, watching Sir Peter's and Robert's stony faces, "Qwest can target the best long distance customers, stealing those who generate the highest profit margins."

No one said anything to me about what they intended to do, and I didn't ask. Robert chuckled at one point, nervously (or was it just that British way), that they had "alternatives," which I hoped implied that they weren't locked in by any confidential addendum. But of course I couldn't be sure.

Clearly, Sir Peter was in a tough spot. His board could easily turn on him if he went ahead with such an obviously overpriced deal. On the other hand, his board could also nail him if, after three years of partnership with MCI, the merger and BT's global strategic plan fell apart. If he tried to renegotiate the deal with MCI, MCI might fight back on legal grounds or simply try to prolong the process, further pressuring BT's share price.

Sir Peter thanked me and abruptly ended the meeting. It had lasted only 30 minutes. I didn't know what to think. Had he cut the meeting short because he thought my perspectives were ridiculous or because he agreed? I had no idea.

As it turned out, I wasn't the only analyst having secret meetings. According to several buy-siders, in the middle of August the Lehman Brothers telecom analyst, Blake Bath, claimed he'd had a private conversation with MCI's CFO, Doug Maine. On the morning of Wednesday, August 20, Blake went on Lehman's squawk box announcing that he had it on good faith from sources within MCI that the deal would definitely not be renegotiated. This was good enough for many members of the arb community, who assumed that Blake's source was Maine and that his former boss wouldn't lie to him. They piled back into the stock, believing that MCI's shares had fallen too much in all the confusion and controversy. If Blake was right and the deal closed as planned, they'd make a ton of dough as MCI shares rose sharply and BT shares fell.

Poor old Blake Bath. He must have forgotten the analyst's golden rule: just because management tells you something doesn't make it true. That very evening, the news broke that the deal was, indeed, being renegotiated. Shareholders in MCI would now get the equivalent of $33.80 for every MCI share, down $8, or 22 percent, from the original $41.80 deal and making the Lehman analyst look like a clueless rube. The next day, MCI shares cratered, falling $6.13, or 17 percent, while BT shares rose 7 percent. This was how he earned the moniker "BloodBath" among some investors. MCI's CFO, Doug Maine, by the way, denied ever telling Blake the deal would or would not be renegotiated.

I couldn't have asked for a more perfect outcome, since I had been predicting a 20 percent drop in what BT would pay for MCI shares. Whatever secret document Jack allegedly saw didn't do much to change the fact that the deal simply no longer made sense at the original price, given MCI's poor performance.

By several accounts, Salomon's arbs lost around $100 million on the deal, since they apparently listened to Jack and his pitch about the confidential document. That was huge bucks even for the bizarre world I inhabited, and rumor had it that this big loss was one of the major reasons why Salomon Brothers sold itself, on September 24, 1997, to Smith Barney, a subsidiary of Travelers Corporation, the acquisitive financial supermarket led by Sandy Weill.[3]

I received a little public vindication as well when CNBC's David Faber called me one of the "winners" in the deal. "Back on July 31, Dan Reingold at Merrill Lynch said 'I think this deal's going to be renegotiated,'" Faber said. "Everybody was saying: 'Dan, you're out of your mind.' But apparently Mr. Reingold knew something that a lot of other people on Wall Street did not." The report went on to name Jack Grubman and good old Blake Bath among the losers. I didn't mind a bit.[4]

I had been completely out on a limb on this deal, but it had worked out for the best. Ironically, the insider edge that Jack was making his signature hurt him this time, while my status as a true outsider—physically removed from the information I needed at a critical time—somehow worked to my advantage.

I felt pretty confident that I'd keep my number one spot. In July, when I'd got the call from the *I.I.* folks, I assumed, or hoped, anyhow, that I was still number one. There wasn't a request for a picture, but I knew they already had one from the previous two years, so I didn't sweat it. But then, sometime in September, a client told me that Jack had told him that he had retaken the top position. A sinking feeling told me he was telling the truth. When the magazine came out the next month, I found out Jack was, indeed, the top dog again, and that I had come in second.

I was very disappointed, as much for my team as for me, as we had busted our butts. But timing is everything, and to correctly predict in August that the MCI and BT deal would be renegotiated in dramatic fashion wasn't nearly as important, in my world, as being right in the spring during *I.I.* voting season. I had been right at the wrong time. At the time of the vote, what buy-side voters remembered was the incredible stock performance of WorldCom, Jack's favorite, which had rocketed from $19 to $26 in the nine months between its acquisition of MFS the previous August and May 1997, when the *I.I.* ballots were mailed. Back then, no one knew that MCI's deal with BT was about to go sour and MCI shares would go into a tailspin.

But actually the truth was simpler than that: Jack was the most energetic, bullish, and visible cheerleader for our entire industry, a once-sleepy group that was suddenly red-hot—and making a lot of people a lot of money. I told my team that number two was something to be proud of. I think they felt a little better, but not much. And I just resolved to work that much harder. Jack had the market's momentum and the inside edge behind him, but I, as always, believed I could grind it out.

Jack and Bernie: Inextricably Linked

Hospitals are like Wall Street in one major respect: the only way to get good information is to get there at the crack of dawn. If you need to talk to a doctor, the best bet is to catch him or her on the early rounds, before the new challenges of the day bubble over and the other streams of anxious families arrive.

This was why my older brother, his wife, and I were pulling into the parking lot of Buffalo General Hospital at 6:30 AM on a chilly Wednesday morning, October 1, 1997. It was just over a month after the BT-MCI deal had been renegotiated. It had been a stressful few days; my mom had had what we hoped was a benign tumor removed from her brain, but we had no idea what her prognosis was. She was recovering very slowly. We had lots of questions for the surgeon about her status, but he'd been impossible to track down, so we decided to ambush him when he came out of the ICU at the end of his morning rounds.

But I was still in the car when my pager beeped with a message from my colleague Mark Kastan. I looked down and read a sentence that I was sure had gotten garbled somehow. It said: "Wcom buying MCI, call my cell now, need to make joint call."

"Holy shit," I yelled. "He must have it backwards." How could tiny WorldCom buy massive MCI? It would be like a minnow swallowing a whale. My brother and sister-in-law turned around from the front seat. I could see the irritation and stress on their faces. Surely I had more important things to think about that morning than some stupid deal. "What company is blowing up now?" my brother said sarcastically, recalling my fiasco with IDB back in 1994, on the day of Jennifer's eye surgery.

"Oh, no, it's just the opposite," I said, still incredulous. "Kastan says WorldCom is bidding for MCI, but he must have mixed it up. This is big. I've got to stay in the car and figure it out. I'll meet you in the

waiting room, okay?"

Of course I wanted more than anything to go inside and figure out what was happening with my mom. But even if the opposite were true, that MCI was buying WorldCom, this was, at the time, the biggest deal ever in our sector, one that would completely realign the telecom planets, and one that I absolutely had to be out in front on. Yes, my priorities were out of order, but that was what Wall Street was all about, wasn't it?

My brother suggested that I stake my claim to the bank of pay phones inside, but I told him I had no time. I had to reach Mark Kastan immediately, figure out what was happening, and decide what our reaction would be. I plugged my cell phone into the car lighter and dialed Mark's cell as he was en route to Manhattan on the ferry from Hoboken, and he said the words I had never imagined hearing: yes, it was WorldCom making an unsolicited, hostile bid for MCI, in an audacious move to try to steal it from BT and to become, in one fell swoop, the second largest telecommunications company in the world.

This was huge news, and not particularly good news, for me. But it was absolutely wonderful news for Jack. WorldCom, this company that Jack had touted incessantly and that I had always regarded as something of a joke ever since that fateful meeting in Mississippi with Bernie Ebbers, was suddenly very much for real. According to the announcement, Mark told me, the deal would increase WorldCom's earnings per share by 22 percent in the first year. I checked the math against our models, factoring in an estimate of savings from eliminating duplicate costs. The numbers jibed with WorldCom's claims. I didn't much like either company, but the combination of the two would change the industry for the better.

"Dan, I know you don't like them," Mark said, "but this deal will add more than 20 percent to earnings per share. That's huge, and it's good for the industry to have one fewer competitor. Let's upgrade WorldCom."

Mark had worked as an analyst at a money management firm for nearly 10 years before joining me at Merrill, and he still thought like a buy-sider. In this case, this meant ignoring the long term and instead focusing on what this meant for earnings in the next few years. If I thought about the deal that way, I had to admit he was right. This was a blockbuster story: the numbers worked like a charm (on paper, at least); and it was the perfect opportunity for us to move over to the bullish side on WorldCom. I'd predicted trouble from the hugely

expensive MFS acquisition a year earlier, and I'd been wrong: the stock had almost doubled in the time frame, and I'd missed every bit of it. By this point in time, the bull market was beginning to take on a life of its own, and the companies that showed the best growth prospects were fast becoming investor darlings. This was the case with WorldCom.

This was a major dilemma. I still didn't feel confident that WorldCom could transform successfully into a telecom giant. Nor did I support the thesis that the long distance carriers like AT&T, MCI, and Sprint had the edge. That was Jack's story. My story was that the Baby Bells had the advantage.

But on the other hand, my job was to help my clients make money, and it was clear to both of us that WorldCom together with MCI had quite a bullish earnings outlook. A marriage of MCI and WorldCom made a lot more sense than MCI with BT, for three reasons: it would reduce the number of long distance competitors; it would combine WorldCom's and MCI's huge long distance networks and sales forces, saving gobs of money by eliminating redundant equipment and employees; and it would help MCI build local networks far less expensively than if it did it on its own.

So I took a deep breath and told Mark he was right. We'd upgrade WorldCom to Accumulate from Neutral, leaving MCI at a "no rating," or "6-6," in accordance with Merrill's rule that we couldn't rate stocks in the process of being acquired.

Knowing I needed some time to focus on my mother, Mark offered to get everything ready for the 7:30 Merrill morning call and page me when it was time to call in. My brother had tracked down the surgeon, and the news was worrisome: the surgery had gone fine, but my mom was coming out of the anesthesia very slowly, which concerned him a little bit and us a lot. We didn't know what to think.

At 7:10, my pager sounded again. "Cleared for call," it read. "7:30 a.m. for 4 mins, pls call ofc now." Twenty minutes later, we would speak to about 150 of Merrill's institutional salespeople and to Merrill's 12,000 retail brokers, who needed a concise summary of our upgrade so that they could call their clients—individual investors—and convince them to buy WorldCom shares as soon as the market opened at 9:30.

I called Mark, who walked me through the latest info on the newswires. It was a hostile bid, with no guarantee that MCI would

accept it. WorldCom was offering the equivalent of $41.50 per MCI share in WorldCom stock, a whopping 41 percent above MCI's current trading price of $29.43 and 23 percent above BT's revised offer of $33.80. From MCI's perspective, there was no way CEO Bert Roberts and the board could turn this down, especially after all of the humiliation they had endured with BT. WorldCom could pay this price because of its high-flying stock and powerful price-to-earnings ratio. When put side by side, WorldCom's offer was virtually the same as BT's original offer. If this deal went through, all of those arbs that had been squeezed so badly would be bailed out if they still held MCI shares.

We spoke on the squawk box together, Mark from Merrill's morning call room and me from a pay phone inside Buffalo General Hospital, where I controlled two lines, to the dismay of hospital visitors who were trying to call their families. I talked on one and checked my voice mail on the other. We explained that we thought one less competitor would be good for the long distance market and that the 20 percent boost to earnings was very positive.

I spent a few more hours at the phone bank, talking with clients and salespeople about the deal and our upgrade. Periodically, I'd take a break and check in at the ICU, where my sister and dad had since arrived, to see how Mom was doing. For lack of anything better to do, they were all watching the coverage of the deal on CNBC, bemused that the faraway stock market was having as much of an impact on my life as what was happening in the ICU a few feet away. We still had little news on Mom's condition.

Although the day was one adrenaline rush followed by another, I must admit that the high point wasn't the call, but rather our quick field trip to the Anchor Bar for lunch. The Anchor Bar was an institution in Buffalo, world famous as the place that had invented Buffalo wings. Every good Buffalonian knows how a real Buffalo wing should look and taste: an oily mix of Tabasco, butter, and cayenne pepper, the requisite plastic tub of blue cheese with some slightly soggy celery nearby. I was starving and stressed, so it was a welcome respite. In the days that followed, my mom's condition started to improve, although she had to stay in the hospital for several more weeks. Her tumor did turn out to be benign.

In mid-October, in a scene reminiscent of the 1980s, local phone company GTE stepped in, countering with an all-cash bid for MCI that most of us on the Street thought was absurd because there was little overlap between the two companies and therefore little in the way of

cost savings. BT remained silent, apparently seeing this as an opportunity to escape the company that, just three months ago, had shocked all of us with a 40 percent cut in its earnings outlook.

But MCI didn't respond to either GTE's or WorldCom's offer, and Bernie lost his patience. On November 10, 1997, nearly a month after GTE's bid, WorldCom upped its offer, announcing in a conference call that it would pay $51 per MCI share in stock, up dramatically from the earlier $41.50. Bernie, ever the cowboy, called Bert Roberts, MCI's CEO, his "new boss" during the conference call, although of course the opposite would be true.

WorldCom's CFO, Scott Sullivan, Bernie's straight man, reiterated his estimates of the cost savings and additions to earnings per share that would result from the merger over the next five years. Indeed, Scott's intimate knowledge of every cost item was impressive. He sure seemed to have a handle on the details.

In the end, GTE folded, BT bowed out, and MCI enthusiastically, or so it appeared, accepted WorldCom's offer. WorldCom had won control of MCI in a deal worth $37 billion. Although I felt a little uneasy about the snake devouring the elephant, it would have been suicidal to bet against WorldCom at this point. WorldCom's bold takeover of MCI, a company four times its size, was the event that signified the arrival of telecom to the center of the world stage.

Our once-sleepy industry was suddenly looking like *Barbarians at the Gate* all over again, with breathtaking hostile takeover offers fueled by a stock market that was making anything possible. In four short years, a tiny upstart company run by a former gym teacher had catapulted itself into the same league as old Ma Bell. WorldCom symbolized how the telecommunications industry had transformed itself from a snooze-inducing swampland to the glamour girl of the Street.

And we, the analysts, were at the nexus of it all. On one hand, we were trying to deliver thoughtful analysis on what the deals really meant; on the other, we were influencing the deals themselves by advising the companies involved and pushing our vision of the industry out to the world with our research. It was a high-stakes balancing act, for sure.

This was also the event that catapulted the team of Jack Grubman and Bernie Ebbers to the top of the telecom universe. The two reinforced each others' power, daring anyone to match their audacity.

Within hours of MCI's accepting WorldCom's bid, Jack Grubman, his disastrous secret-document claim now a relic of the past, told anyone who would listen that he was the guy who convinced Bernie and Scott to make the offer for MCI. He may or may not have been, but it didn't matter: Jack's behind-the-scenes role in WorldCom's acquisition of MCI made him into a magnet for the buy-side. Money managers and buy-side telecom analysts began to realize that Jack might know about market-moving events before they were announced. He brandished his image as the telecom industry's consummate insider, one who orchestrated mergers and acquisitions, brought in big fees for Salomon's bankers, and according to some buy-siders, provided advance notice of upcoming deals. All I could do was sit back and watch.

Jack Plays Loose: I Play Banker

A few months after WorldCom won MCI, the next round of Bell mergers got rolling. SBC, formerly Southwestern Bell, pounced on Ameritech, the Chicago-based Baby Bell. SBC would now have a geographic reach that covered one-third of the United States, stretching from California to Texas to Ohio. The $62 billion deal was announced on Monday morning, May 11, 1998, and made perfect sense to me. The two companies had lots of duplicate costs that could be eliminated. Plus, an enlarged service area was particularly important for improving service to traveling ("roaming") cell phone customers and for SBC's plans to begin offering long distance services.

That wasn't the spin the chairmen, Ed Whitacre of SBC and Dick Notebaert of Ameritech, used, however. They promised the deal would help the American consumer because the money the merged company saved would be used to build its own startup local carriers in areas outside its own traditional service regions. That, they argued, would bring competition and lower prices to customers served by Baby Bells Bell Atlantic, BellSouth, and US West. To pitch the deal as pro-consumer was absolutely critical because the Federal Communications Commission and the Antitrust Division of the U.S. Department of Justice were beginning to take a hard look at whether the telecom merger wave had gone too far.

Although I was a supporter of the Baby Bells, I thought Ed Whitacre and Dick Notebaert's pro-consumer story was total bull and was presented for one reason only—to get government approval. It was too late and far too expensive, in my opinion, for SBC, or any of the Bells, to begin the long process of building local telecom carriers

in other areas, and they were probably too slow and bureaucratic to get it done anyhow. And, most important, the Bells had lots of great opportunities to grow *inside* their own regions by offering long distance, wireless, and high-speed Internet access services. So what was the point of major spending outside their home areas?

But that wasn't what Jack Grubman was saying. Suddenly, the guy who had ridiculed everything the Bells had done for the past several years did a complete about-face. Jack wrote, "The reason we have always liked Ed Whitacre is in a sense he reminds us of Bernie Ebbers."[5] Given Jack's endless worship of Bernie, it seemed that he was anointing SBC boss Ed Whitacre a king.

In my mind, Ed Whitacre was indeed very smart and savvy, and I liked his personality. He was a circumspect and serious Texan who avoided the Internet and dot-com hype that so many others in the telecom industry were embracing. Jack's firm, Salomon Smith Barney (SSB), was SBC's adviser on the deal. Even though Jack had argued that SBC's purchase of PacTel and Bell Atlantic's acquisition of NYNEX were both bad moves, he now lauded this similar deal as brilliant and good for both consumers and shareholders.

Many savvy buy-siders looked cynically on what Jack was doing. One e-mailed me later that morning, attaching Jack's report on the merger with a cover message: "Here's the JG scoop—and to me it reads as if he is getting paid by SBC for this note. In other words, for SSB to get the big money on this it has to go through, and for that to happen the DOJ must be satisfied that this will probably add to competition. If you like this deal—which you seem to—I'd pipe down and let JG do his magic!" I doubt that SSB's retail investors understood it quite this way.

I don't know for sure whether or not Jack was brought over the Wall on this deal and therefore knew about it beforehand. But on May 6, 1998, just five days *before* the merger was announced, Jack had come out with a report called "CLECs [Local Startups] Surpass Bells in Net Business Line Additions for the First Time." Never mind that his math was wrong. What mattered was what he wrote toward the end: "If [a Baby Bell] acquires assets for capabilities that take them away from being a regional carrier on defense into a more offensive, fully-integrated national or even global provider, then we would gladly rethink our investment position on that particular [Baby Bell]."[6]

What he seemed to be signaling was that if a Baby Bell began to compete out of its home territory, exactly what SBC and Ameritech

were now announcing, he would consider upgrading it. There was nothing illegal in a statement like this, but it sure seemed to me that he already knew something was coming and that he was laying the groundwork for the news to come and for his radical reversal of opinion.

On the morning of the merger announcement, May 11, Jack published a long and detailed report on First Call, the wire service for research reports, at 10:09, just 20 minutes after the Whitacre and Notebaert investor conference call about the merger had ended. I had barely finished listening to the call and had just begun to write up my initial comments when his report crossed the wire. He didn't give any recommendations about SBC or Ameritech shares, because, with SSB advising SBC, his compliance department would likely have limited his commentary to the publicly announced facts of the merger. Since Salomon would be collecting a fat fee for advising SBC, it would face a conflict of interest between its corporate client, SBC, and its investor clients. Nevertheless, he did brashly add a few sentences that 99 out of 100 compliance officers would have—and should have—deleted.

"From an SBC perspective, *assuming this line is kept in by our lawyers,"* he wrote, "we think the strategic moves they are making will clearly be additive to long-term shareholder value."[7] In effect, he had issued a buy recommendation on SBC, and even Jack thought he was going too far, hinting that that line would be deleted. But it wasn't.

In conversations with my buy-side clients, I also learned that Jack had been telling people that morning that SBC had been planning to announce a deal to purchase an unnamed startup local carrier at the same time as it announced its Ameritech acquisition. The implication was that such a deal might still happen. Had he been told this in over-the-Wall meetings? I figured this, along with the comment in the research report, might set off alarm bells over at the Securities and Exchange Commission. Maybe, finally, someone would start an investigation.

The next day, I wrote a client the following e-mail: "…Interesting to essentially upgrade a stock for which he is restricted. He may have finally tripped the wires at the SEC…. Word is he is whispering that the original SBC plan was to announce [an acquisition of a startup local carrier] today in addition to the Ameritech bit."

The client wrote me right back. "As for JG, it was no whisper. His salespeople left me a message saying he thought SBC would announce a [local carrier] deal with the Ameritech deal but it will come soon."

With information like that, money managers might load up on a group of startup local carrier shares that day and hope for a big takeout price on one of them. But the deal never came: Jack's information, wherever it came from, might have been juicy, but it wasn't always right. Just like the BT-MCI secret addendum.

What was most fascinating about this deal was that Salomon got the banking business even though Jack had been negative on SBC before the deal was announced, rating it only a "3," or Neutral. Was this because SBC, to its credit, didn't pay attention to the research position of the analyst and simply hired the bankers it liked best? Or was it more strategic than that? Did SBC hope to turn Jack around with this deal, bringing the top-ranked telecom analyst to its side? We'll probably never know. But when I visited Ameritech's CEO, Dick Notebaert, in Chicago later that month, he told me that the folks at SBC had assured him an upgrade from Jack was in the offing.

My banker colleagues were distraught. Neither company had hired Merrill as a merger adviser, and they were particularly distressed to be excluded because it would cause Merrill to suffer in the M&A "league tables," a ranking compiled by Securities Data Corporation (SDC). SDC measured the value of each M&A deal and tracked which investment banks had been hired as advisers. Its results were published every quarter in *The Wall Street Journal* and *The New York Times.*

These league table rankings were to investment bankers what the *I.I.* magazine analyst poll was to sell-side research analysts—a very silly measure that often inspired absurd behavior. Just as analysts traveled to Birmingham, Alabama, for a one-hour meeting with one voter, bankers offered services for cut-rate fees. Merrill was building a very successful M&A practice and, at this moment, it was ranked number one, leading Goldman Sachs by about $40 billion. But this deal was worth $62 billion, so missing out on this merger would push Merrill down in the rankings and boost the firms hired by SBC and Ameritech—Salomon and Goldman Sachs.

I was really perturbed. I felt strongly that SBC was hiring Salomon to buy an upgrade from Jack and get the benefit of his influence in Washington. The first, I thought, was wrong, and the latter would backfire. The staffers at the FCC had to know Jack's games. So, motivated by a sense of outrage and hoping to help my firm as well, I did something I'd never done before: I decided to don the banker hat and try to convince Ameritech to hire Merrill as its second adviser (in addition to Goldman Sachs). I met with Ameritech's conservative CFO, Oren Schaffer, in New York and basically pulled out all the stops. I

explained that 30 of the past 38 mergers had had two investment banks representing each side, and that Merrill would work for as little as $1 million. It simply wanted its name attached and league table credit. I also told Oren that they and SBC looked silly cuddling up to Jack. “Everyone knows that his positive comments are driven by banking fees,” I said. “The regulators will see through him too.”

This was an aggressive role for an analyst to play, one that could certainly be perceived as a conflict of interest. But I had not been forced into it by anyone on the banking side, nor would my compensation be impacted by the outcome. Banking interests had never affected my investment opinions, and I had been positive on SBC and Ameritech and on Baby Bell mergers for three years already, anyhow. I simply wanted to help my banking colleagues, and I’d had it with Jack’s questionable methods.

Oren punted, suggesting that I meet with his boss, Dick Notebaert. So, a few days later, I flew to Chicago and met Dick for breakfast at the Four Seasons Hotel on Chicago’s Near North Side. I knew Dick well, as he had been a top Ameritech executive when I started at Morgan Stanley. He was short like me, sarcastic, and into corny practical jokes. Back in 1994, when I was cautious on the Baby Bells, I had written that they were stuck in a “dividend straightjacket”—meaning their investors were demanding continuation of the annual cash dividend when I believed that the Bells should invest their cash in new growth businesses. Dick sent me a real straightjacket after reading that report. I suppose it was funny.

Still, I thought Dick was a logical and reasonable guy. So I laid out the same argument again. He listened carefully, and said he appreciated the issues. He also explained his choice of Goldman Sachs. Goldman, he suggested, would likely be very helpful in getting the merger approved by federal regulators, since Bob Rubin, former co-chairman of Goldman Sachs, was now U.S. treasury secretary in the Clinton administration. Dick said that he’d get back to me.

Five days later, in early June 1998, he did. I picked up the phone anxiously. “I’ve talked to Oren,” Dick said. “And we just can’t do it.” Ameritech was not going to add Merrill as an adviser. I conjured up various excuses in my mind. Perhaps he and Oren feared I’d be restricted from recommending Ameritech and SBC shares while the merger was awaiting shareholder and government approvals. Or maybe it was that, for all its connections, Merrill didn’t have anyone as politically powerful as Bob Rubin.

Whatever the reason, I was disappointed. I had tried to play rainmaker to help my firm's banking business, and I had failed miserably. As Jack had suggested back in the 1980s, and as I had somehow forgotten, I was a lousy salesman.

But maybe Ed Whitacre and Dick Notebaert had the right idea after all. In early January 1999, eight months after the merger was announced and immediately after both sets of shareholders had approved it, Jack would upgrade SBC to Buy, or "1," SSB's highest rating, from his previous Neutral, or "3."[8] He had, indeed, turned, although it may have cost SBC $25 million in merger fees paid to Jack's firm, Salomon Smith Barney. And in March 1999, the Antitrust Division of the U.S. Department of Justice approved the merger with very light conditions. The FCC followed suit in October, and the two companies formally merged on October 6, 1999.

How I Lost My Bank $25 Million

By the middle of 1998, the deals were coming so fast and furious that it was hard, if you were an investment bank, not to be bringing the dollars in hand over fist as you locked in to one underwriting fee after another. Bad deals, good deals, who cared? All that mattered, increasingly, was bringing new companies public, especially technology and telecom companies.

But a few firms were taking the lion's share of the business, and suddenly Merrill wasn't always one of them. Was that because of Jack's relentless bullishness? Because of Frank Quattrone, now at Deutsche Bank and formerly of Morgan Stanley, who had the tightest connections to most of the technology and Internet startups coming out of the West Coast? Goldman Sachs's high-level connections? Some failure on the part of Merrill's investment bankers? My refusal to play ball and join the hype brigade? It was hard to know. But what was clear was that life wasn't getting any easier for any of us at Merrill.

The pressure to greenlight deals and catch up to our hated rivals felt relentless. In an e-mail to a friend, I wrote "My calendar has been absolutely uncontrollable over the last two or three months. A bull market seems to bring every IPO candidate in the world out of the woodwork. Sometimes I think my job is a screener—like those people who read books and movie manuscripts all day to determine which ones ought to go forward."

Case in point: Pathnet, a new Washington, D.C.–based company that intended to wire up rural America, where AT&T and others had

spotty coverage, using microwave technology instead of fiber. Pathnet intended to then wholesale this capacity to other telecom companies that, the theory went, needed it to meet the exploding demand from the Internet and cell phones. When the company announced it was planning to go public, the Merrill team reacted like a dog in heat. If the IPO succeeded and raised, say, $100 million, its bankers would earn roughly $6 million, a nice payday and hopefully the beginning of a long stream of other Pathnet deals ranging from bond issues to acquisitions to additional stock offerings.

Megan and I had done a lot of homework on this company, and we didn't feel good about it. At the bankers' request, I met with Dave Schaeffer, Pathnet's chairman, several times and I wasn't impressed. The market size seemed a lot smaller than they asserted it was, the business plan seemed flawed, they'd hired a lot of second-rate executives from other telecom companies, and the executives had bragged to us that AT&T would be buying a lot of their capacity. But that wasn't quite true. Megan learned that AT&T was not at all committed to buying Pathnet's capacity. I decided I couldn't support Pathnet's IPO. There were just too many unsettling things about this company. And there was no way that Merrill could take the stock public without the support of its analyst.

But the bankers didn't know our viewpoint in June 1998, when they called Megan and me into a meeting in the corner office of Mark Maybell, head of all of Merrill's telecom and media banking, along with Tom Middleton, Merrill's top telecom banker, and Sean Wallace, the banker working with Pathnet.

"Dan, we've got to do this deal," began Wallace, a smooth-talking, overzealous, midlevel banker for whom I already had little respect. "I've already told them you are on board," he said.

Megan and I looked at each other. He had already told them I was "on board"? I wasn't. Nor, sadly for Wallace, was I about to be. It was a dog of a company, and I knew it. If I threw my weight behind Pathnet, I was setting myself up to fail, not to mention hurting Merrill's investor clients.

"Sean," I said indignantly, "you're asking me to put my name behind a brand-new company using a technology that is actually antiquated [microwave radio], and their largest potential customer tells us that they may not buy much from them!"

“I thought you were okay with this,” he sputtered. “You and Megan have met with them several times, and you’ve even called some of their customers. Besides, we already have given our word [that we’d underwrite the IPO] to their venture capitalist owners in Silicon Valley. If we bait and switch, Merrill will never get any IPO business out of the Valley again.”

Essentially, Wallace was arguing that I was going to torpedo Merrill’s entire investment banking business. The logic went like this: tech was the biggest banking opportunity in the world, and Silicon Valley VCs (venture capitalists) controlled most of the technology IPO candidates. In order to break into this deal flow, Merrill’s relations with the VCs had to get a lot better fast. So if I turned down Pathnet and the venture capitalists took it as a sign that Merrill was too conservative to work with the startup world, Merrill Lynch’s bankers would be screwed.

“Sean, I agree that you have a problem,” I said. “But I can’t solve it for you. And anyway, why the hell did you promise my support without consulting me? If we lose business in Silicon Valley, it won’t be my fault.

“And I know one more thing,” I said, looking at the other bankers: “If you guys had to put your name on a report about Pathnet, you’d be doing the same damn thing I am doing!” The bankers weren’t happy with our intransigence.

I wasn’t happy either. These guys were trying to pressure me into supporting a lousy deal, and beyond that, they were trying to shift the entire weight of Merrill’s investment banking future onto my shoulders. Mark and Tom would have loved it if Wallace’s plan to ambush me into supporting Pathnet’s IPO had worked. But I could also tell that they thought Wallace was as much of a jerk as I did for committing my support without my approval, and then trying to ram it down my throat.

I didn’t change my mind, so the bankers ultimately had no choice but to tell Pathnet we couldn’t do the deal. The company never did go public. But of course no one could know that at the time. All they knew was that Dan Reingold and Megan Kulick were pain-in-the-ass, stick-in-the-mud analysts who were messing up Merrill’s deal flow in a big way.

BY THIS POINT, I had managed to antagonize just about everyone, especially my own bankers and some of the companies I covered. I had hoped that this wouldn't translate to my buy-side clients, but perhaps somehow it did, as I remained in the number two spot on the *I.I.* poll for the second year in a row, unable to dislodge Jack from his land of boundless sunshine and everlasting opportunity.

So I decided to get a little taste of sunshine myself, booking a week down in Florida with Paula and the girls in the last week of December 1998. We were going to spend some time with my parents and my brother and his wife, all of whom lived in Delray Beach, and relax a little bit.

I was also considering upgrading AT&T, because I was impressed with recent strategic moves undertaken by its new CEO, Mike Armstrong. I needed some time away from the hubbub to look closely at our models, sketch out a mock report, and decide whether it was the right time for an upgrade.

On Thursday morning, New Year's Eve day, we were sitting in the living room of my parents' home. Paula was talking to my mom, and my daughters were out on the patio reading, while I outlined an AT&T report on my parents' old IBM ThinkPad. CNBC was blaring on the television, because my dad watched it all day every day, as so many retirees do. Suddenly reporter David Faber came on with breaking news: According to his sources, Bell Atlantic, one of the Baby Bells, was bidding for AirTouch, the wireless division of Pacific Telesis that had been spun off in an IPO in December 1993. Oh, boy, I thought. There goes this vacation.

About 10 minutes later, my cell phone rang. It was Tom Middleton, the Merrill telecom banker, and I could tell by his tone that it was urgent. Could I be in Manhattan by Saturday morning, he wanted to know, for a meeting with a very important client who had requested my presence? I knew it had to be Bell Atlantic, although I wasn't over the Wall yet. I knew that Merrill had advised Bell Atlantic when it bought Nynex in 1997 for $23 billion and just five months earlier, in 1998, when it announced its merger with GTE for $68 billion.

I didn't think Bell Atlantic should buy AirTouch, because it would be extremely harmful to Bell Atlantic's earnings and stock price. Bell Atlantic was still struggling to get its acquisition of GTE approved and digested. Another huge acquisition would significantly lower, or

dilute, Bell Atlantic's earnings per share. "Why do they have to buy the damn thing when a joint venture brings all the benefits of national coverage without the costs?" I asked Tom. His answer was simple. "Get up here and you'll see we're past that point already. Now we have to decide how high we go." I guess I was going over the Wall on this one.

I told Tom I thought it might be difficult to get a flight given that it was New Year's weekend, but that I'd try. Paula could tell from the snippets she'd overheard that another disruption was in the works.

My brother wanted to know if this had to do with the AirTouch news, and my 87-year-old father, who didn't have good ears, was convinced it was a done deal—that Bell Atlantic and some very large cellular company had merged. "David Faber said so and he is always right," he exclaimed. Mom and Dad had thought Faber was God ever since he anointed me the "winner" in his story about the BT-MCI renegotiation. I mumbled that I didn't know if anything was going on with Bell Atlantic and AirTouch. They knew better than to ask again.

Tom called back several hours later. "Dan," he said, "don't worry about getting a flight. The Bell Atlantic jet will pick you up at West Palm Beach Airport Saturday at 9:00 AM. There is room for your family if they want to go too." Other than having to say good-bye a day earlier than planned, this was going to work out just fine. I gave the kids the choice of another day in Florida or a ride on a corporate jet. They chose the jet. They'd always wanted to ride in a limousine, and I explained that this was even better: it was an air limousine. The kids got their first corporate jet ride, and my parents and brother got to think I was a big deal. After BEL 005 touched ground at Teterboro Airport in New Jersey, I said good-bye to Paula and the girls, and hopped into one of the waiting cars and went straight to Bell Atlantic's headquarters at Forty-second and Sixth.

En route, I pulled out the rusty ThinkPad that I had commandeered from my parents, and continued writing my AT&T upgrade. I had been thinking about it the entire week and had outlined the logic in my head. I wrote in a stream-of-consciousness manner, leaving blanks for data and tables, and e-mailed it to Megan and Ehud Gelblum, an engineer I had recently recruited from AT&T Labs. I told them it was uncertain whether we would go with it, but they should assume yes for now and thus get all the tables and models ready to go.

I *didn't* tell them that I was actually in New York. I couldn't, because, knowing I had come home sooner than scheduled, they would instantly conclude that Bell Atlantic was, in fact, bidding for AirTouch and that I was over the Wall. So while they sweated away at the office thinking I was still in Florida, I walked in through the side door of Bell Atlantic's headquarters and was sent up in the double elevators with a security escort to the 39th floor, where Ivan Seidenberg, Bell Atlantic's CEO, and Fred Salerno, its CFO, had their offices.

Ivan Seidenberg was one of the executives I had liked the most in all of my years on Wall Street, probably because he was the antithesis of Joe Nacchio. Raised in the Bronx, Ivan was a Bell lifer whose first job was working as a cable splitter—installing and repairing copper cable lines underneath streets. Although he was a CEO, Ivan still went to Jets games every weekend with his longtime buddies. Although a lot of people underestimated him because of his calm, low-key approach, I thought he was one of the most astute of the Bell bosses. He was the type of guy who listened well, took in all of the information, and then came to a rational decision. He preferred to deal with problems through quiet negotiation rather than in inflammatory free-for-alls. In short, he was my kind of guy.

I was now officially over the Wall, and it was going to be tough to figure out how to handle the rumors, which were already being breathlessly reported by every television station and newspaper out there. I knew that the guy who ran the Merrill morning call would be all over me to make some comments on Monday. I hoped that whatever the outcome, it would become public before the weekend ended.

When I walked into the conference room, I saw Ivan, Fred, several other Bell Atlantic executives, Tom Middleton, and two other Merrill bankers—Michael Costa and Francisco Rey—sitting among reams of paper spread all over the table. Fred thanked me for coming and began to update me, assuming that I knew everything that had gone on so far. Of course, I didn't have a clue, since I hadn't spoken to Middleton for 36 hours; all I knew was what Faber had reported on CNBC.

So I listened and nodded my head. Everyone was going through various prices to be paid for AirTouch and looking at the negative impact on earnings. They discussed the possibility that Vodafone, a British wireless telecom company that had partnerships or equity stakes in almost every country in the world except the United States,

might also bid. But Chris Gent, Vodafone's CEO, was out of touch at a cricket tournament in Australia, so no one knew what to expect. The bankers and executives went through a series of scenarios, all of which hurt earnings by over 10 percent, with some as high as 25 percent or even 30 percent. For a slow but stable earnings grower like a Baby Bell, these were some seriously large and negative numbers. Although I thought the deal was a bad idea, it would be a great one for my firm; a $45 billion bid meant a potential fee for Merrill of approximately $25 million.

The meeting ended on an expectant note, with everyone wondering whether Vodafone would make a bid. The next day, they did. We were called back in for a long conference call with GTE, which was still in the process of merging with Bell Atlantic, and its CEO, Chuck Lee. The terms of the Bell Atlantic–GTE merger specified that neither company could undertake a major strategic move without the approval of the other, so Chuck had veto power over this deal. GTE's bankers were Salomon Brothers, so a bunch of its bankers and Jack Grubman were also on this call.

Jack prattled on for about 20 minutes about how terrific the deal would be, how Bell Atlantic should outbid Vodafone so that it would have a national wireless "footprint," and how size and scale were going to determine the winners in telecom. Chuck Lee was in favor too. Everyone liked the deal, it seemed. Except for me.

The call ended, and Ivan and his CFO, Fred, indicated that they wanted to speak with me privately in Fred's office. Ivan asked me whether or not Bell Atlantic should bid again, and if so, how high it could go without its stock falling too far as a result of selling by investors displeased by the hit to earnings that would result.

I took a breath and in the course of ten seconds helped to lose Merrill one of the biggest deals of the year, if not decade.

"You are better off letting Vodafone win," I said. "Then it will have to come to you to partner. AirTouch will still need to have national coverage and there is no better, in fact no *other,* way to accomplish that than partnering with you. This way, your stock will go back up out of relief that you didn't make such a big acquisition with such a big effect on earnings. And your cellular customers will still get nationwide coverage but at a far lower cost."

Fred and Ivan just sat there, listening. Ivan, as always, had a poker face on. Finally, the CFO looked over at Ivan. "I think that's where

we're headed, Ivan," he said, which was Fred's way of making a recommendation to his boss. Ivan didn't say anything at all.

When I came out of Fred's office, Michael Costa and Tom Middleton, the Merrill bankers, accosted me, wanting to know what had transpired. I told them that I had suggested they not make a counterbid. If the Bell Atlantic executives listened to me, that meant a lot of work and no payday for Merrill and lower bonuses for its bankers, especially these two.

Clearly, they were disappointed, but these bankers weren't stupid. As much as they wanted the fees and as frustrated as they must have been with me, they also agreed with my reasoning. And hopefully Ivan and Fred would respect Merrill for its sound, non-self-serving advice, and that would translate into some other payday some other time.

On January 15, 1999, AirTouch accepted Vodafone's counterbid of $66 billion, or $97 per share. Bell Atlantic never made another bid. And by September of that year, Gent had come to Bell Atlantic with a joint-venture proposal. I felt that I had saved Bell Atlantic shareholders a bundle. But I had helped to lose my firm roughly $25 million, the M&A fee for one of the biggest deals in history.

6. Oxygen Deprivation

1999

"You know, Dan, our stock is down $4 today," he said, with the kind of bellowing laugh that can emanate only from a wealthy man, "and I've lost almost a billion dollars in just a few hours! Can you believe that? My net worth is actually down a billion dollars today!"

I laughed, as apparently was required. I guess it was somehow truly amusing that the coming or going of $1 billion did not really seem to matter. What a 1999 moment.

My Multibillion-Dollar Mistake: AT&T

PERHAPS IT WAS simply the pressure of dealing with so many companies and deals at the same time. Perhaps I was beginning to feel out of step with a stock market that knew no bounds. Perhaps I was swayed by the charisma of a new, überconfident chief executive. Whatever the reason, I kicked off 1999 with a multibillion-dollar mistake—one of the worst decisions of my professional life.

Way back in October 1997, AT&T's board had finally made a bold move after a humiliating series of events. First, CEO Bob Allen had bullied the board into choosing the corporate empty suit John Walter as AT&T's CEO-in-waiting. Then, when it became clear Walter was a disaster, the press had excoriated the board for paying him $26 million in severance for nine months of work. On October 20, it brought in a new CEO, C. Michael Armstrong, a dynamic turnaround specialist from Hughes Electronics Corporation. The market loved this choice, and AT&T stock leaped more than 16 percent, from $43 to nearly $50, in the two weeks between the time the rumors began and the decision became official.

Armstrong, a balding, impressive smooth talker with a disarming smile who seemed to understand technology, quickly charmed the press and the Street, in part because he had miraculously transformed

Hughes Electronics from a defense contractor to a satellite TV business, DirecTV. In many ways, AT&T was like the Hughes Corporation Armstrong inherited in 1991—a dying giant with a need to spend enormous sums to gain a foothold in a new business. The changeover at Hughes had been painful, involving huge employee and cost cuts, significant startup costs to get the satellite TV business underway, and enormous risk. Armstrong openly acknowledged that it was a bet-the-company strategy, and it had paid off.

After his predecessors, dull powercrat Bob Allen and the woefully underqualified John Walter, Mike Armstrong had the aura of a savior. He tackled AT&T's problems head-on and laid out a clear action plan. He did nothing to discourage the increasingly popular belief that if anyone could fix this broken company, he could. I listened to everything he said and liked what I heard. Still, I remained skeptical: I thought that AT&T had simply delayed the inevitable for far too long and that Armstrong's challenge might be simply too great and too costly. So I left my rating at Neutral for quite some time, even as my institutional investor clients became enamored of Mike and AT&T shares rocketed to $75.75 at the end of December 1998. Anyone who followed my advice missed a huge run-up.

From the beginning, Armstrong promised to address AT&T's main problems: getting local access to add to its established long-distance prowess and expanding its international reach. His first big move came in January 1998 when he bought Teleport, the startup local phone company that Mark and I liked so much, for $11.3 billion, thus gaining an instant presence in the market for local phone service for business customers. To address the local phone market for consumers, he bought cable company Tele-Communications International. And finally, in December 1998, just before Bell Atlantic's run at AirTouch, Armstrong announced he was buying IBM Global Network, an IBM business unit that provided communications services for large multinational corporations around the world. He had filled AT&T's major strategic holes in less than a year. I started to wonder if this guy really was the knight in shining armor for this antiquated old bureaucracy, and whether I should think about upgrading the stock.

So I did what I always did in these circumstances: I began a debate with myself and with all of the people whose opinions I respected, such as Bill Newbury, TIAA-CREF's (Teachers Insurance and Annuity Association-College Retirement Equities Fund) telecom and cable analyst and a major client of mine. Newbury was a major bull on AT&T and taunted me, saying that I was missing the biggest stock in telecom. I absorbed the digs. It was always fun to argue an unpopular

position, and since I had actually been quite right for a long time (AT&T did eventually go as low as $30.75 after I downgraded it three and a half years earlier, when it was trading at $55), I wasn't too concerned. But the conversation did add to my growing sense that some important things were going on at AT&T.

The other point that got my wheels turning was that it had been widely reported that AT&T was considering using a *tracking stock* to separate its cable and wireless divisions from its long distance business. The use of tracking stocks allows a company to create separate stocks for different units. It would separate the big startup losses of AT&T's fast-growing cable and wireless businesses from the slowing but still-profitable long distance business. This came at a time when the stock market was paying incredible premiums for fast-growing businesses, even those with no earnings, while devaluing old "traditional" assets—in this case, AT&T's voice long distance business.

With Armstrong's recent acquisitions, the company now had a chance to radically transform itself. I thought the tracking stock, if it did what it had done for Sprint and others, would give AT&T more financial flexibility and a higher stock valuation. I set up a meeting with Dan Somers, AT&T's CFO, to discuss AT&T's future. I asked him whether the tracker was still going to be announced at next month's annual analyst meeting, and he smiled reassuringly.

So with the tracker as the news hook, in late December of 1998 I decided to upgrade AT&T, outlining my thoughts during that family vacation in Florida before I was interrupted by the Bell Atlantic–AirTouch negotiations. I knew there was an AT&T analyst meeting scheduled for Friday, January 8, 1999, and I thought the upgrade should come out just before then. By the time I got off Bell Atlantic's jet, I had started typing up the AT&T draft report on the way to Ivan Seidenberg's office. That Saturday, of course, was taken up by the over-the-Wall meetings at Bell Atlantic, but as soon as I got home I shifted gears, spending two close-to-sleepless nights editing the draft. We went out with the AT&T upgrade on Merrill's morning call on Tuesday, January 5, raising the stock one notch, from Neutral to Accumulate. AT&T shares traded up about 2 percent that day, a sign, I figured, that my argument resonated with investors.

The next morning, I got a call from the Merrill banker responsible for the AT&T relationship, telling me that I would be brought over the Wall on Thursday for an AT&T rehearsal in order to help it prepare for its Friday analyst meeting, which would have several hundred analysts, money managers, and journalists in attendance. It was a

hectic week for me, with my AT&T upgrade, a trip to Arkansas, and two over-the-Wall sessions for two different companies within four days.

I showed up at AT&T's bucolic Basking Ridge, New Jersey, headquarters and strolled into the boardroom, expecting a boring day listening to predictable slide presentations. The sell-side analysts had the best seats, and I was seated directly across from Mike Armstrong, with Jessica Reif-Cohen, Merrill's cable analyst, to my left and Jack Grubman next to her. Frank Governali of Goldman sat to my right, with Denny Leibowitz, the legendary DLJ cable, media, and wireless analyst who had been rated number one in his category on the *I.I.* list for over 15 years, to the right of him. Along with a few other analysts, there were several bankers. I was just about to settle into my seat when the Merrill banker pulled me into a corner.

"Dan," he whispered, not messing around with pleasantries, "the tracker is canceled."

It was one of those moments that seemed to last for hours. I could feel the blood draining from my face and my legs beginning to wobble. How could that be possible? I had just upgraded AT&T in large part because of the likelihood of a tracking stock for AT&T's wireless and cable units. I would look like a complete and total fool without the tracking stock plan. Geez, Connie Weaver, who several years earlier had left MCI and become AT&T's head of investor relations, had even named her dog Tracker!

Just then, Mike Armstrong walked in, brimming with confidence as usual, and sat directly across from the other analysts and me, flanked by AT&T's key executives. The bankers in the room were relegated to seats along the periphery. Mike asked everyone to take their seats and took a small piece of paper out of his shirt pocket on which he'd handwritten his own notes. No cue cards or teleprompters for this guy; it was impressive. After thanking everyone for coming on such short notice, Mike began reading from his crumpled piece of paper. He explained that he'd decided not to do the tracker because AT&T shares had done very well lately, and since the point of the tracker was to attract investors, perhaps it wasn't necessary.

Armstrong emphasized that he could always return to the tracker if he thought the company or its stock price needed it. I tried to look impassive, but I was burning up inside, thinking about how everyone in the room knew how bad I looked, and that many of them were enjoying my misery. Wrapping up, he said he'd like some feedback

from the analysts in the room before he gave us a preview of the next day's presentation. "How do you react to what I just said?" Armstrong asked. "How will the market react?"

I could barely think straight. All I could think about was what a fool I was going to look like the next day, and if he really wanted to hear what I thought, it wasn't going to be pretty. I watched as the analysts, one after another, each told Armstrong he was making the right decision. I waited for the others to finish speaking, partly because I wanted to hear as many perspectives as possible, but also because I desperately needed time to figure out what to say and how to say it without looking as if I was chewing on a bunch of sour grapes. Finally, it was my turn.

"I disagree," I said, trying my best to sound professional and change Armstrong's mind. "In this market, if you don't unlock the value in the high-growth but money-losing cable and wireless units, you are robbing AT&T of future growth opportunities." I added that I thought that most around the table would agree that Sprint's two trackers together had achieved a higher stock market value than otherwise would have been achieved, and that this gave Sprint PCS, the wireless portion, the ability to spend more money and to build out its network more rapidly. Everyone was silent for a moment, until Armstrong, sounding a bit perturbed, thanked me. It was clear that his decision was final and he was just practicing his speech.

Finally, at the end of the day, Connie Weaver, AT&T's investor relations head, told me Armstrong wanted to meet with me in his office. She took me in and closed the door as she left. It was unprecedented for Connie to leave me alone with an AT&T executive —she was infamous for never letting that happen—but I guess Armstrong wanted this to be totally private. I walked in and took a seat on his couch. He sat down in the lounge chair to my right.

I didn't know what to expect. If it were Joe Nacchio, I would have received a verbal spanking: "Who are you to question a decision that my board, my management committee, and 29 well-trained bankers and analysts in that room today agree with?" But that would have been Joe. Mike Armstrong was a gentleman and a professional. I imagined he'd say something like, "You know, Dan, you have the respect of many people in this industry, but in the future if you don't agree with an aspect of what I'm doing, please tell me privately."

But he was a lot subtler than that. In fact, he hardly acknowledged my earlier comments and reiterated his excitement about AT&T's

future. “Dan, you know you can call me anytime you want,” he stated. Was he insinuating that if I had called him and asked about the tracker, he would have given me nonpublic inside information about the tracking stock being scrapped? I doubted that, but I didn’t know what he really meant. I told him I appreciated that, but it was not my style to run my draft reports by management before I published.

It turned out that AT&T investors didn’t see the decision as a problem. Much to my surprise and relief, AT&T shares did not fall following the analyst meeting the next day. They held steady, a sign that investors still liked AT&T, tracking stocks or not. Ehud Gelblum, the most recent addition to my research team, and I wrote a report summarizing the meeting, titled “AT&T: The Magical Mystery Tour Continues: More Notes from Bullish Analyst Meeting,” reflecting my amazement that investors continued to believe in Armstrong even when he flip-flopped. Indeed, the stock continued to soar, moving up 22 percent to an all-time high of $95 over the next thirty days and bailing me out—for the moment. Thank God for this crazy market, I said to myself.

“You’re Missing the Fucking Boat on Level 3”

The Internet boom was now in full swing, and rather than being a phenomenon that would include telecom, it began to define telecom. No longer were the companies I covered relevant because of the traditional phone calls or voice communication they transmitted. Now it was all about data transmission, which was growing at what appeared to be an exponential rate. Data transmission meant sending e-mails, pictures, huge data files—you name it—over the Internet. Just as the railroads had unleashed the power of America’s manufacturing muscle a century earlier, the telephone, cable, and wireless companies were laying the tracks (fiber-optic, in this case) to connect the virtual economy. Or so went the hype.

I had been fully aware of the Netscape IPO, Al Gore’s information superhighway, and, of course, the stock market hype that was exploding all around me. But the light hadn’t really begun to click on inside my head until that August 1996 meeting with Jim Crowe, who was then the CEO of MFS. I first heard at that meeting about Internet protocol, or IP, the technology that would be built into the telecommunications networks of the future and could truly transform every company I followed.

I had believed for a long time that the voice long distance business was in big trouble because of competitive pressures. But it began to

occur to me that the growth in data traffic from the Internet could possibly make up for the pressures on the voice side. If the demand for this stuff was as dramatic as Jim Crowe and others were saying, perhaps it wasn't just the Baby Bells that would be the winners; perhaps everyone would win. Still, I was skeptical that anything could grow at the rate that some were predicting.

And the predictions were shocking. In 1997, Michael O'Dell, the chief scientist at UUNET, the Internet services provider that WorldCom had bought a year earlier, was the first of many to proclaim that overall Internet traffic was doubling every 100 days. Later that same year, at an analyst meeting for WorldCom, John Sidgmore, WorldCom's vice-chairman, announced that demand for bandwidth was doubling every 3.5 months. By early 1998, even the U.S. Department of Commerce was echoing O'Dell's 100-day statement and delivering bullish reports to Congress on the Internet's potential.[1] And these numbers were still being presented a year and a half later. In May 1999, Sidgmore told *Red Herring* magazine that "the Internet continues to grow at 1,000 percent a year in terms of bandwidth demand."[2]

These numbers were hard to believe. But, then again, I thought to myself, WorldCom does run the largest Internet transmission service in the world, so it was not unreasonable to view its traffic growth as a rough approximation of the overall market's growth, even if it wasn't sustainable forever. Reinforcing the bullish point of view was the fact that even the slow-growing Baby Bells were reporting 30 percent growth in their data services divisions, far beyond the 4–6 percent growth rates of more traditional Bell product lines. O'Dell's and Sidgmore's numbers would go on to become those "statistics" that everyone cited as gospel without knowing where they came from or whether they were actually true.

In May of 1998, I attended the grandly named Vortex Conference, a dot-com and technology get-together organized by Bob Metcalfe, the scientist from Xerox's famous Palo Alto Research Center who invented Ethernet, today's standard for rapid computer networking, and later founded 3Com. It took place at the Ritz-Carlton in Laguna Niguel, California, a gorgeous resort south of Los Angeles overlooking the ocean. But no one there cared much about the surf. The conference was chock-a-block with new companies trying to get funded, existing companies touting their technology, and, of course, bankers, analysts, and investors.

The speakers included John Chambers, CEO of Cisco Systems,

Internet guru George Gilder, and others. Frank Quattrone, tech banker extraordinaire, was there, mobbed by startups looking for funding or merger partners. Sol Trujillo, CEO of US West, was there, trying desperately to gain some credibility as he tried to transform his company, and himself, from a boring old Baby Bell into a "new-economy" superstar. And Jim Crowe, my flat-topped buddy from MFS, was there, spreading the Internet word again, but this time on behalf of his new company, Level 3 Communications.

One afternoon as we sipped cocktails by the Ritz's pool overlooking the Pacific Ocean, Jim explained to me that Level 3 was going to provide the tubes through which the information economy would flow. It would run a national long distance network that would carry only data, not voice. By this time, Jim Crowe was viewed as an Internet deity, having been early to the game with MFS and then selling it at a huge premium for WorldCom stock, which then soared. The response to his new company was as frenzied as a Michael Jackson concert in the *Thriller* days.

As we sat by the pool, Jim sketched out on a piece of paper his vision of the Level 3 network in the hope of convincing me to begin covering his company. I looked at the paper, which had a lot of swirls and chicken scratches, and saw nothing. To me, the whole thing seemed like just gibberish. I didn't get it. And although it made me nervous that just about everyone else said they did get it, I wasn't going to start coverage of a stock if I couldn't fathom what the company actually did.

Some clients tried to convince me of Level 3's merits. One was Bill Newbury of TIAA-CREF, who had helped talk me into the AT&T upgrade. Janus Funds, a big new-economy mutual fund group, loved the stock so much that its portfolio managers wouldn't even meet with me when I came to Denver, because, I supposed, they figured I would dis the company and they didn't want to hear it. I was beginning to feel like a Luddite, stubbornly sticking to the stuff that could be measured as the rest of the world rushed onward. Were they right, or was I?

Level 3 was a virtual fee machine for Wall Street firms because it was constantly raising money by selling bonds and stock. Making matters worse was the fact that Crowe, who obsessively quantified everything, also quantified the performance of the banks he hired. He developed a bizarre measurement system that graded the banks on everything from the number of calls a banker made to Level 3's CFO or treasurer each month to try to drum up business to the number of

calls an analyst made to buy-side clients to talk about Level 3's stock. How he got that data, I have no idea.

A Level 3 document I received in 1999 listed the criteria he used to measure the banks' performance. Number two on the seven-point list was "Equity Research Commitment," measured in the following ways: "Analyst calls made to institutions/investors. Analyst one-on-ones with investors. Perceived strength of analyst and analyst's understanding of, and confidence in, Level 3's Plan. Ongoing research coverage of Level 3."[3]

All of these factors were compiled into one total score that would presumably determine the portion of Level 3's business each bank would be awarded. Clearly, Crowe saw the analyst and the banker as inextricably entwined. It was troubling. I never heard of another company that had such an explicit method for monitoring its investment banks. But this was Jim Crowe to a tee. Needless to say, he wasn't a big fan of mine, and the three firms I worked for never got much business from him.

By March 1999, my refusal to cover Level 3 was becoming a major problem for Merrill, made even worse by two rah-rah reports issued by Jack Grubman the month before. The first one, a two-pager on February 18 that raised Jack's target price to $70 from $54, came out the same day that Level 3 announced plans for a huge secondary stock offering—underwritten, of course, by SSB.

Four days later, he put out a massive, 39-page report titled, "Level 3 Communications: Optimizing a Layer of the Telecom Value Chain: The Intel Inside of Telecom."[4] In it, he outdid himself. Discussing how bandwidth was the "enabler of the Internet," he exclaimed that bandwidth-centric companies such as Level 3, WorldCom, Global Crossing, Qwest, and a startup local carrier called Metromedia Fiber Network were *"good values at any price."* Jack's reasoning? Internet-based applications were growing exponentially, he said. "This is why we believe *the value of these stocks will perpetually rise* as long as management executes."

The National Association of Securities Dealers (NASD), the securities industry's self-regulatory organization, requires that all Wall Street research reports have a "reasonable basis" for their conclusions. How could a view that stocks will rise "perpetually" and that some stocks are "good values at any price" be reasonable? This wasn't analysis by any stretch of the imagination. It was hyperbole and should have been stopped by SSB's compliance department, its

research directors, or the NASD. If he had stood outside on a street corner yelling these inanities at the top of his lungs, people would have thought he was completely bonkers. But, when this stuff showed up in a Wall Street report by a big-name analyst, even professional money managers with Harvard MBAs lapped it up.

Jack's target price increase looked to me like an overt attempt to "condition" or hype the market for Level 3's offering by building demand for the new shares. And condition it did! Despite the fact that announcements of secondary offerings almost always temporarily depress a company's stock price, according to *The Wall Street Journal,* his target price increase caused the stock to jump from $51.75 to $54 a share.[5]

With such strong demand, Jim Crowe decided to up the number of shares offered by 25 percent, to 25 million. By my calculations, without Jack's report, Level 3 shares normally would have traded down to roughly $50 per share. So, in effect, Jack netted Level 3 a cool $100 million because Level 3 was able to sell its 25 million shares at a price of $54 each, approximately four dollars higher than it would have otherwise. Advantage: Level 3 and its bankers. Disadvantage: small investors, who had no clue what was going on and paid $4 per share more than they would have just days before. The amazing thing was that this was happening in plain sight of everyone, from investors to regulators to the readers and writers of *The Wall Street Journal*—and no one seemed to mind. No wonder every CEO wanted Jack on his side!

Jack's lock on Level 3 didn't stop my Merrill buddies on the banking side from trying to get a seat on its gravy train. Although Level 3 did most of its business with Salomon, Crowe also liked to spread the business around a bit, with the expectation that the research side would play ball. On one deal, with no help from me, Merrill managed to get included as a low-level co-manager, and Frank Maturo, a pushy banker who had just moved to Merrill from Salomon, decided to pay me a little visit. He sat down in my office and told me that Level 3 was simply the greatest "fucking company" he had ever seen.

"Fuck, you guys, you're missing the fucking boat," he said, mentioning his "great fucking relationship with Crowe." Lots and lots of business would come Merrill's way, he said—as soon as I started recommending its stock. He even said that Jack was not responsible for all the business Salomon did with Level 3; instead, Frank claimed,

“I fucking was.” Frank had quite a broad vocabulary.

I decided to do what had always served me best—play it straight. “Frank, let me tell you three things,” I said, beginning with a nice one. “One, it’s very nice to meet you. You are truly different from anyone I have ever met at Merrill and I suppose your high energy level and aggressiveness might be needed in this somewhat sleepy firm. Two, I doubt Level 3 is the greatest company in the world. And three, we’re pretty busy here and Level 3 seems to be getting hyped up all over the Street. Its stock is very high, so it may be too late to recommend the shares anyway. If we can find some time, we’ll take a look, but no promises.”

Frank didn’t hear a word I’d said. He just kept repeating what an incredible stock Level 3 was going to continue to be, how well connected he was, and how much money he could make for Merrill Lynch if only the telecom research analyst would get on board. He wasn’t there to listen to an analyst. He looked on analysts as the first wave of privates on Omaha Beach, the heroes to be sacrificed for the higher good. But this was one war I wanted to sit out.

“You Know He Can’t Keep His Mouth Shut”

March 1999 was a tense time: our Global Telecom CEO Conference was fast approaching and we were in the final stages of panic, praying, as we did every year, that our key speakers wouldn’t cancel. This year, I had invited everyone from WorldCom’s Bernie Ebbers to AT&T’s Mike Armstrong to Ed Whitacre, SBC’s chairman and CEO, as speakers. On Thursday, March 11, just four days before the conference was to begin, I was on the way back from visiting clients all over the southeastern U.S. when I got a call from Michael Costa, Merrill’s telecom M&A banker: “Dan, we need to bring you over the Wall on something tomorrow afternoon. Will you be back in time for a 2:00 PM meeting at the midtown offices of [top law firm] Skadden Arps?”

A day later, I was sitting in a conference room with Jack Grubman as a bunch of bankers briefed us on Global Crossing’s pending confidential offer to acquire Frontier, the former Rochester Telephone Company, which had recently added long distance, data services, and Web-hosting to its repertoire of phone services. These assets made Frontier a very attractive acquisition. Both Salomon and Merrill were representing Global. My old colleagues at Morgan Stanley were the bankers representing Frontier. Talk about incestuous!

Global Crossing was the new international long distance company

that had gone public with a bang in August 1998. It had laid cables under the Atlantic Ocean and intended to run fiber-optic cable all the way around the world to meet the exploding demand for Internet and telecommunications access. Global Crossing had sold just 25 percent of its cable capacity under the Atlantic Ocean—the "Atlantic Crossing"—and had already recouped 90 percent of its costs.

In March 1999, Global looked like a home run. From its IPO price of $19, it was now at $48, having doubled in the first three months of this year alone. Before Global's IPO, former president George H. W. Bush gave a speech to the company's most important customers and opted to be paid in pre-IPO stock instead of taking his usual $80,000 honorarium. That decision netted him $14 million.

Global Crossing's founder was Gary Winnick, a former junk-bond salesman at Drexel Burnham Lambert, Michael Milken's hotshot firm, whose fortunes had evaporated when Milken pleaded guilty to securities law violations in 1990.[6] Winnick was a heavyset, wide-shouldered Long Islander who would have looked right at home in a used car lot. I initiated coverage of Global Crossing shares with a "2," or Accumulate, rating, meaning I predicted a rise of 10–20 percent over the next 12 months—fairly unimpressive numbers in the context of what was happening to most stocks in the tech and Internet categories. Yet I was intrigued by what appeared to be very strong demand for the company's undersea fiber.

Because Global was perhaps the premier "new-economy" company in the telecom sector and had been seen as purely an international play, its decision to acquire Frontier was a shocker. Frontier was an old-economy real telecom company, not a virtual one. This meant a major strategy change for Global Crossing. The deal, which preceded the AOL–Time Warner merger by almost a year, was the first case in which an upstart new-age company with few customers but major growth expectations used its high stock valuation to buy a traditional company. Global Crossing was offering a very rich price for Frontier of $62 per share, 41.3 percent above Frontier's current price of $43.88. I was very happy with the transaction. It validated my Buy rating and target price of $60 on Frontier, and my view that Frontier was a takeover candidate. Moreover, the Luddite in me thought it was terrific for Global, since it now would own a traditional company with real assets, real customers, real revenues, and real earnings.

The bankers told us that the deal would likely be announced the following Wednesday, after both companies' boards met and approved

the deal on Tuesday. Damn, I thought. This meant the press conference and analyst meeting would interfere with my own conference, siphoning off my attendees. The Morgan and Salomon folks were probably thrilled, as an unsuccessful conference might mean fewer votes for me and a lower stature for Merrill's telecom franchise.

So we swung into action, quickly offering to let the two companies announce their merger at our shindig. We would shuffle some speakers around and create a one-hour slot early in the morning so Global Crossing's and Frontier's CEOs could present the deal and the new company's plans. We convinced the executives that they would get far greater attention with all the major large investors in one place. We even offered to let my competitors from other Wall Street firms into the Grand Hyatt's ballroom for the meeting, which normally we wouldn't have done.

We couldn't flag the schedule change, since it was confidential information and astute buy-siders would quickly suspect something was up. Last-minute events such as CEO or CFO cancellations were watched closely by professional investors because they often signaled important news in the offing. I did not tell my team about the upcoming merger, nor did they have any reason to suspect anything.

But apparently, other people did. Monday morning, as I was exiting the hotel elevator and approaching the coffee and muffins, stopping to greet every client I could, one of my most important clients pulled me aside. With a big shit-eating grin spreading across his face, he said:

"So, Dan, who's going to buy Frontier on Wednesday for $62 a share?"

I blanched. He was blatantly flaunting the secret information he had. I looked down to try to hide my shock. How could he know? And what made him think I knew something about it? If I implied I knew, he'd take it as a confirmation and I might be illegally disclosing inside information. Fortunately, I was already harried, since in about five minutes I had to go to the podium and make my opening remarks.

"Wow, I didn't know that," I said, concentrating on holding my poker face. "Where did you get that from?"

"Oh, I went to a boxing match with Jack on Saturday night. You know he can't keep his mouth shut."

"I'll try to check into it," I said. "Let me know if you hear anything more, but I've got to get into the ballroom. I think I'm late already." I didn't have time to think too much about the leak; it was time to get the conference started. But it had happened again—with a deal I knew about this time. I wish I could have said I couldn't believe my ears, but by this time, sadly, I could.

Later that day, Megan told me that same client also approached her and posed the same question, saying he had heard it from Jack at the Lewis-Holyfield heavyweight boxing match at Madison Square Garden on March 13. She, of course, had no idea what was going on at the Skadden law offices across the street and thus simply exclaimed, "Really?" and probed him for more.

Later that afternoon, Michael Costa, the Merrill banker, found me in the Grand Hyatt hallway and asked me if I could meet with Global's board at around 2:00 PM the next day at Skadden's office. They were asking both Jack and me, separately, to give our sense of how the markets would react to the deal. It was going to be very tough for me to sneak out of my own conference without anyone noticing, but I managed to get to Skadden at about 2:05 PM on Tuesday. I was shunted off to a small conference room and informed that the board would call me when it was ready.

After about a half hour, I was getting antsy. I wanted to get back to my conference before anyone noticed I was absent. I certainly didn't want to miss the 4:30 meeting I had arranged with our dinner speaker, Steve Case, AOL's chairman and CEO. Although about 700 clients attended the conference, I had invited a select group of my top 25 clients to this meeting, which had to be kept very quiet. These kinds of meetings were highly sought after by buy-siders, because lots of important information came out. This was just another example of the fact that even the institutional investors didn't play on an even playing field. Some would have a chance to chat in near-private sessions with Steve Case, while others had to try to trap him on his way to the men's room before his speech.

Finally, bored and anxious, I took a walk down the hallway. I spotted Global chairman Gary Winnick milling about by some snacks. We chatted about the deal, and I suggested to him that if the market reacted well to this one, he ought to keep going, leveraging his supercharged stock as currency for the acquisitions of other companies. Chuckling, but somewhat serious at the same time, I said "Gary, I don't see why you don't buy US West and then BellSouth."

Gary's eyes lit up. He clearly liked the idea. But it soon became clear he had something else on his mind.

"You know, Dan, our stock is down $4 today," he said, with the kind of bellowing laugh that can emanate only from a wealthy man, "and I've lost almost a billion dollars in just a few hours! Can you believe that? My net worth is actually down a billion dollars today!"

I laughed, as apparently was required. I guess it was somehow truly amusing that the coming or going of $1 billion did not really seem to matter. What a 1999 moment.

Much less amusing was the fact that Global Crossing shares had fallen so much today, while Frontier shares were up $2.50, just a day ahead of the merger announcement. It looked as if the news of the merger had leaked out to more people than just Jack's boxing buddy.

As I stood there with Gary, being introduced to a few of the board members and to Tom King, a Salomon banker, someone came running out of the conference room looking for Gary. "Gary, I've got Joe [Clayton, Frontier's CEO] on the phone. You need to talk to him." He and Bob Annunziata, Global's CEO, went into the conference room, returning about 15 minutes later with worried looks on their faces. Gary told me there was a last-minute snag with "those bastards in Rochester," but that it would work out. By 3:00 PM, another phone call came through, and everyone was relieved: they had a done deal.

We all went into the conference room, and the board members asked for my reactions to the deal from Global Crossing's perspective. I told them it was a smart move, but that they should be prepared for some skepticism from those Global shareholders who were true believers in the power of the Internet.

"The market has given Global a currency with which to build itself, via acquisition, into a major company in this industry," I said. "And you should use that currency while the bull market supports it." Everyone listened politely. I finished and dashed back to my conference, slipping in just in time to introduce Steve Case to the 25 lucky buy-siders who were awaiting the private session.

Steve Case was up there with Level 3's Jim Crowe as one of the most passionate advocates of the Internet, only he was a little more approachable. He was as ebullient as you'd have expected from an AOL CEO in 1999. Case was also our dinner keynote speaker. Over

700 buy-siders crammed into the Grand Hyatt's ballroom and an overflow room. Sitting at Steve's table was the new Merrill Internet analyst, Henry Blodget, a group of five buy-siders I'd handpicked, and me.

Before Case sat down, I leaned over and whispered to Henry, "Henry, you want to introduce Case as our dinner speaker, right?"

"Yeah, I should do that. You know I've never met Case. It will be interesting to introduce someone who I've never met."

Hmmm, I thought to myself. This guy covers AOL and, on behalf of Merrill Lynch, recommends its stock to thousands of individuals and institutions around the world. How can he publish research reports on a company without having ever met the driving force behind it? Geez, I bet sixth graders feel they know Steve Case better than Henry Blodget does. After all, Steve regularly writes e-mails to AOL subscribers.

Henry did a fine job introducing Case and moderating the Q&A session. No one could tell these two men were meeting each other for the first time. It was so un-Grubmanesque. Henry had a vision. He didn't seem to need insider relationships. In fact, it didn't seem to have even dawned on him that those relationships were necessary at all. How different the paths to Wall Street stardom and notoriety can be.

The next morning, Wednesday, March 17, the Global Crossing–Frontier merger was announced at about 7:00 AM. Megan said, "You knew this all along, didn't you? And Jack told [the client], didn't he?" I shrugged my shoulders. "I just can't believe he can get away with this much longer," I said. It was just another day in M&A—except, of course, for those who knew about the deal before it happened. For them, it was a great day.

The SEC's Deadly Mistake

As I stood in the back of the Grand Hyatt's ballroom at my conference listening to Global Crossing's Bob Annunziata and Frontier's Joe Clayton outline the deal's terms and their joint future, Megan came over and asked, "Are we going to write this up or are we restricted?"

"Restricted, I'm sure," I whispered in reply. "But check with compliance." Since Merrill's bankers were advising Global Crossing, I assumed I would not be able to say or write a word about the deal or

either company until the merger was completed, which could take months. I had learned many years earlier that federal securities regulations didn't allow a Wall Street firm to issue research on a company when the firm was acting as a financial adviser to that company. This was intended to avoid the accidental leakage of inside information and to keep research analysts from *conditioning the market*—hyping a stock's price or biasing shareholders in some way.

There was another factor, too: although Merrill was going to be paid $20 million for its advice to Global Crossing, most of the fee was contingent on the deal being approved by shareholders and regulators. My opinion, if positive, could easily be interpreted as trying to influence shareholders to vote yes on a deal that my firm had millions riding on. I certainly didn't want my clients to view my research as tainted, and I figured Merrill's watchdogs would have the same view. So, when clients approached me at the conference, asking what I thought of the deal, I could only explain, "Oh, sorry, looks like we're gonna be restricted for a while, since we're advising on the deal."

An hour or so later, Megan slipped me a note while I sat on the dais listening to our next speaker. It said, "Restricted yes, but we can write the facts. Should I write it up?" I nodded yes, and thanked her.

Although it was a relief to be free of the pressure to opine on the deal, being restricted hurt me in other ways. It gave me fewer topics to talk to my clients about, which might push them into the arms of my competitors. The timing was particularly bad in this case because *I.I.* voting season was fast approaching. Factual summaries didn't help, because they couldn't include forecasts, stock recommendations, or target prices for the two companies involved in the merger—and therefore, added no value for my institutional clients, who had access to the same facts. The factual summaries were really written for Merrill's retail brokers and, indirectly, their individual clients whose only other information source would be newspapers and CNBC.

Now, I'm no securities lawyer. But I figured the other firms involved in the deal, Salomon Smith Barney and Morgan Stanley, would also restrict their analysts. Salomon, along with Merrill, was Global Crossing's banker, while Morgan Stanley advised Frontier. But I was wrong: the next morning, Jack issued a seven-page report upgrading his rating on Frontier shares two notches, to Buy ("1") from Neutral ("3") and dramatically raising his Frontier target price to $80, from $38 per share. He argued, correctly, that Frontier shares should be viewed as a derivative of Global Crossing's. As such, his new Frontier rating and target price were derived from his new target price

on Global Crossing, which he pegged at $72 per share.

Although Jack hadn't explicitly issued an opinion on Global Crossing, since Salomon had represented Global and he was restricted from issuing an opinion about it, he had managed to get his point across indirectly through his Frontier report: the deal was a great one for both companies and shares of both companies offered tremendous upside to investors. Global Crossing shares were worth $72 at a minimum, 53 percent above their current price. And Frontier was worth at least $80.

I realized instantly that I (and Merrill) would be at a major disadvantage if I wasn't publishing opinions on these two companies and Salomon was. Our traders would do less trading and thus make less in commissions. The same would hold for our 12,000 retail brokers, who would have no recommendations to pass on to their customers. And Gary Winnick, Bob Annunziata, and Joe Clayton, I figured cynically, weren't going to be very happy if one of the two banks they were paying millions to for merger advice went mute for the next three or four months. So although I felt that publishing anything like what Jack had done would be the wrong thing to do, I figured I'd better get some professional help to be sure.

The next morning, with my conference over, I walked down the hall to Merrill's research compliance department. "How come Grubman can write this stuff?" I asked Ray Abbott, the compliance department's resident lawyer, waving Grubman's Frontier upgrade in front of his eyes. "I'm restricted, right? Why isn't he?"

Ray took a glance through the report and said he saw my point. He then said there had been some changes in SEC regulations in late 1997. Ironically, he said, Merrill had actually been the firm that convinced the SEC to loosen up its research regulations a bit on M&A deals. But now Merrill's competitors were using it to their advantage.

"It's called a No-Action Letter," Ray said. He tried to explain the SEC's logic, but when he saw my eyes glazing over, he called another Merrill lawyer and asked him what I could and could not write about.

It turns out that this "No-Action Letter" was an extremely significant document, one that inadvertently further intertwined banking and research, put analysts in even more conflicted positions, and made investor interests subservient to those of investment banking clients.

It worked like this: prior to the ruling, the SEC prohibited research analysts from issuing opinions on companies that had hired their firm's investment bankers for M&A work. This had two results, one good and one bad. First, it kept the research analyst's opinions from being influenced by the interests of the bankers or their corporate clients. Otherwise the analyst might be pressured to put out a positive opinion on the companies involved, helping convince the companies' shareholders to approve a proposed merger—and guaranteeing a fat fee to his firm. The second, unintended, effect was that individual investor clients of, say, Merrill Lynch, no longer had access to the analyst's recommendations and explanation of the transaction, leaving them in the dark if they had an account with only one brokerage firm.

On October 21, 1997, Merrill's law firm wrote a letter to the Securities and Exchange Commission. Merrill said it would like to be able to publish analyst recommendations on the shares of an investment banking client even while a merger or acquisition was pending.[7] The SEC responded with its "No-Action Letter," which is not a formal approval but rather an assurance that should Merrill do what it proposed, the SEC would not take any punitive action.[8] The SEC wasn't saying that doing this was right or wrong, but rather that the commission would not interfere if Merrill or, indeed, any investment bank did issue some recommendations.

The letter therefore essentially sanctioned behaviors like Jack's bullish report on Frontier and Global Crossing, even though the merger was awaiting approval and his firm's fee was contingent on the deal going through. Before the No-Action Letter, a firm with an influential, well-respected, and bullish analyst often lost out on deals because the corporations involved knew the analyst would be muzzled in order to avoid the possibility of conflicted research. They did not want to lose that analyst's bullish influence while the deal was underway.

The letter turned that upside down. Now that analysts were no longer restricted from commenting on pending deals, it made sense for corporations, in search of supportive commentary and higher stock prices, to hire firms with pliable or bullish analysts. Arthur Levitt, who was chairman of the SEC in 1997, gave speeches castigating analyst conflicts of interest. But he also presided over the creation of one of the most pernicious and costly conflicts in the history of Wall Street.

I didn't understand any of this at the time. So, when Ray phoned another Merrill lawyer, I sat and listened in to the call, taking copious notes. After a while, yet another Merrill lawyer was brought onto the

call as well. As the call dragged on, it became clear to me that each of the lawyers had different interpretations of the SEC's regulations, and that there was no clear answer. I had to leave for a client meeting, so we agreed to meet again the next day.

When we reconvened, I don't remember who said what, but the group of lawyers spent a lot of time trying to justify my publishing research on this deal. One suggestion was for me to write a detailed report on Frontier but not on Global Crossing, explaining the merger terms, forecasting revenue and earnings for Frontier, and setting a target price for Frontier shares. This was what Salomon had allowed Jack to do and would be okay, the argument went, because Merrill's bankers, like Salomon's, were advising Global, not Frontier. However, in contrast to Jack's report on Frontier, I wouldn't be allowed to give Frontier shares an investment rating.

Nevertheless, if I set a target price for Frontier based on the number of shares of Global stock it was being offered, any reasonably intelligent professional investor would be able to deduce my target price for Global Crossing. I would leave blank what Jack had spelled out explicitly: the pros would know what I was thinking about both stocks, but the amateurs—the individual investors who lacked the time or expertise to read through these tea leaves—would know far less.

It was all very convoluted and inconsistent. My mind was spinning. I was in a jam, and no one was offering me a clear way out. If I wrote anything positive, it would be perceived as urging shareholders to vote in favor of the merger. And then one of the Merrill lawyers topped it all off by telling me that there was some risk the SEC would sue us if we followed this plan. Someone else chimed in that it could be an important test case of the rules.

"Whoa," I yelped to Ray, who was sitting across from me. "So I'm the guinea pig for these legal guys to test the SEC's rules? No way, José!" (Ray thought I said, "No way Ray.")

Ray interjected, "Neither Dan nor I are comfortable with the scenario you guys have painted. Do you have any other ideas for us to consider?"

Two more ideas were offered. I could simply write nothing—and mark the stocks as "restricted" in the Merrill computer systems. Or I could continue to write factual reports as I already had, again with the rating column marked "Rstr" for restricted. I nodded positively to Ray,

and it was resolved. I would stick to "just the facts, ma'am," like Sergeant Friday in the 1950s television series classic *Dragnet,* and issue no ratings, forecasts, or target prices on either stock.

But I came away with two very disturbing conclusions: one, that the lack of clarity in the No-Action Letter was actually doing more to promote analyst conflicts than to resolve them, and two, that people in all different parts of my firm were interested in pushing the envelope any way they could in order to promote banking and trading. The lawyers were not so much pressuring me as facilitating me. If it wasn't explicitly barred, it must therefore be okay. It was a scary and sobering realization.

"How Can Your Best Friends Become Your Worst Enemies?"

Just one month after the Global-Frontier merger announcement and just two days after *Forbes* had published a big cover story on Gary Winnick, Global Crossing's chairman, entitled "Getting Rich at the Speed of Light," I flew to Los Angeles for my annual West Coast marketing tour and asked Gary to lunch. I brought a copy of the *Forbes* story for him to autograph, and he was flattered, just as I had intended. The article pointed out that Gary had reached $1 billion in net worth faster than anyone in history—even Bill Gates.

Gary was dressed in a suit, and the first thing he did was to introduce me to his personal trainer, some TV workout celebrity. Gary promptly began his workout on the treadmill—with his suit still on. Perhaps this was meant to show what a fabulous multitasker he was. Perhaps he had simply scheduled us both at the same time by accident. But someone probably should have told him that suits don't breathe too well. I felt sorry for whomever he was meeting after his workout—until I remembered that we were going to have lunch together. Sheesh.

While Gary ran on the treadmill, I visited with some of the other Global executives. Then Gary and I went to lunch together at Hillcrest, a country club in Beverly Hills. Gary introduced me to a woman whose son wanted to go to Cornell Law School. I guess she was a good friend, because he told me he had donated $100,000 to Cornell to get him in. As we ate, person after person stopped by to congratulate him on the *Forbes* cover. Gary, who puffed up with pride, was thrilled to be perceived as one of the kings of the new economy. When we were able to speak uninterrupted, I repeated that I thought a Baby Bell would be his best buy going forward.

Exactly six weeks later, on May 17, 1999, Global announced another deal: it was acquiring Baby Bell US West, even before its Frontier acquisition had closed. I had heard nothing about it until the evening before, when the Merrill bankers asked me to go over the Wall and show up at the Rainbow Room at 6:00 the next morning, armed with a list of tough questions that the two CEOs, Sol Trujillo of US West and Bob Annunziata of Global, should be ready for before their presentation to analysts later that morning. Salomon was advising Global, and Merrill's telecom banking team—switching sides this time—was advising Global's prey, US West.

Sol Trujillo, a friendly but intense career US West employee who had worked his way up to the top, clearly saw this deal as a way to transform his conservative, slow-growing, dividend-paying telecom company into a high-growth new-economy outfit. He had been enamored with the buzz—and stock prices—these new-economy companies were fetching ever since he had attended the Vortex Conference at Laguna Niguel a year earlier.

But neither Global Crossing's nor US West's shareholders were enthusiastic about the deal. The conservative US West holders saw it as radical and risky, while Global Crossing's holders, new-economy-Kool-Aid drinkers, saw it as a waste of money on old, tired assets. Global's shares, which had hit an all-time record of $64 a share by May 13, fell 30 percent in three weeks, closing at $45.75 on June 2. US West shares fell, too, by 15 percent, in part because many of its shareholders lacked confidence in Global.

The pressures on Sol to find a better deal were mounting. And it didn't help matters any that the analyst at their investment bank—me—was not publishing anything but factual research on his company, US West. The US West executives were livid, especially because they saw Jack Grubman at Salomon publishing aggressive buy recommendations on Frontier and, by extension, Global Crossing. In effect, Jack had written a glowing prognosis for a merger even though Salomon's fees, like Merrill's, were contingent on the deal going through.

US West couldn't understand what was going on. After all, I'd had an Accumulate, or "2," rating on US West before the Global Crossing–US West deal was announced. What had happened to it? Al Spies, US West's CFO, feared that investors were perceiving my silence as opposition to the deal. "How can your best friends become your worst enemies?" Al asked one of our bankers. I wasn't an enemy, I tried to explain. I was simply trying to avoid any allegations of conflicts of

interest. But that didn't do them much good.

While the US West–Global Crossing marriage foundered, over at Qwest Communications, many of the largest and most important buy-siders were pressuring its CEO, Joe Nacchio, to do something equally grandiose with his equally high-flying stock. Eventually, he called the telecom bankers at DLJ, one of the few unattached firms in this banking feeding frenzy. US West had hired Lehman Brothers in addition to Merrill, Morgan Stanley was advising Frontier, and Salomon was on the Global Crossing side.

Joe told the DLJ bankers to prepare a bid for both Frontier and US West. On the evening of Sunday, June 13, 1999, while Qwest's PR team called reporters, Qwest's chairman, Phil Anschutz, called Sol Trujillo, and Joe Nacchio called Frontier's CEO, Joe Clayton, to explain their proposal. Qwest was offering a total value of $32 billion, or $61.37 a share in Qwest stock—only a dollar more than what Global's offer was now worth—for US West; and $11.4 billion, or $61.70 a share for Frontier, roughly equivalent to Global's $62 offer. Joe and Phil were assuming, apparently, that Qwest was a more appealing partner and thus didn't need to outbid Global by much.

They were wrong. When the markets opened on Monday, Qwest shares sank faster than a mobster in cement shoes. They fell 24 percent that day, from $44.88 to $34.13, and proceeded to fall another few dollars to $32.50 over the next two weeks. Apparently, investors were worried that the bidding war would escalate into an out-of-control war of egos, and that Gary Winnick and Joe Nacchio were violating their new-economy creed by selling their souls to the old world.

Believers asked themselves, Why would any company that was all about the infinite growth in demand for Internet communications waste its valuable stock on an old-school company whose copper wires were already obsolete? Or, more chilling still, did these companies know something their investors didn't—that their stock prices were overinflated, and that their true business prospects weren't good enough to go it alone? Both choices spooked investors, and the result was a market that gave both possible combinations the Bronx cheer.

Nonetheless, Qwest's CEO and its chairman, Joe and Phil, never good losers, decided to up their offers by $4 billion. On Wednesday, June 23, Qwest issued a press release announcing it was now offering $69 for US West shares and $68 for Frontier shares. Several weeks passed with no apparent movement. Yet behind the scenes, I

subsequently learned, both companies were beginning to realize that this bidding war was hurting everyone. Eventually, both Joe and Gary sent out feelers via their bankers to look for a compromise, or at least a cease-fire. A harried, complex series of four-way negotiations ensued. Bankers and lawyers scrambled.

By Friday, July 16, the egos appeared to have been wrestled back to Earth. Global and Qwest agreed to a truce: Qwest would get US West for $69 per share, and Global would get Frontier at $63 per share. All four boards voted approval, and the PR teams began to prepare press releases.

But that, of course, would have been too easy. A major snag occurred as the lawyers and the bankers were meeting at DLJ's offices to put the finishing touches on the documents and get ready for a celebratory dinner. Early in the negotiations, Phil Anschutz, Qwest's chairman, had told Sol that he and Joe would be co-CEOs of the newly merged companies, or at least that is what Sol understood. When the US West board voted in favor of the merger, the deal they approved had them as co-CEOs.

But Joe had no intention of sharing power with anyone, particularly not with some Bellhead. He had dealt with too many of those guys during his 26 years at AT&T. So when someone from his public relations office asked him to approve some language describing the setup, he blew a gasket. He ran down the halls of DLJ in search of Tom Middleton, the Merrill banker, and yanked him out of a meeting and into an adjoining conference room. As Tom told me years later, Joe closed the door, poked Tom in the chest, and said, "If you think I'm going to be co-CEO with that bozo, you are wrong! I don't know where that idea came from and if it stays, the deal is off."

Tom, trying to stay cool, told Joe that that was the deal that had been approved by US West's board, and for that to change, there would have to be another board vote. "US West will have half the board seats," Tom told me that Joe yelled, incensed, "and that will give them veto power over all major decisions. They don't need to have a co-CEO and, besides, what a stupid idea. You better go back and tell them we have a serious problem here."

It was now 6:00 PM and the documents and dinner plans were being finalized. When Sol heard about Joe's threats, he was not a happy man. But he was in a pickle. His largest shareholders liked the Qwest deal and were far less concerned about his ego than their financial returns. They respected Joe as a terrific telecom manager,

even if his brash personality rubbed some of them the wrong way, and many felt that Joe's style was exactly what was needed to make it in this Wild West telecom industry. More important, with the deal's terms already fully vetted in public, Sol could not possibly ask his board or his shareholders to walk away from the deal because he was not happy with his own role.

Sol knew Joe had maneuvered him into checkmate. Sol reconvened his board by phone and recommended approval of the new deal with himself as co-chairman and Joe as CEO and co-chairman. Joe would run every aspect of the company and Sol's role would be largely ceremonial. US West's board approved the recommendation. And poor old Sol retreated to his hotel room.

I hadn't been over the Wall for any of this, and I'd been happy about that. From what I could tell from the outside, it was a huge mess. But then Tom Middleton called. He told me that Joe and Sol wanted the research analysts at their bankers' firms to help them prepare for the announcement by anticipating questions, reviewing the slide presentations, and playing devil's advocate. With his usual sarcasm, Tom said "Dan, you and Paula aren't going to golf camp this weekend, are you?" Middleton was referring to the year before, when I'd canceled golf school after Bell Atlantic announced it was buying GTE. The funny thing was that we *were* about to go, and this time I wasn't missing it for anyone.

"Well, Tom, that's great," I said. "Congratulations to you. But, in fact, we are signed up for golf camp again, and this time we're going to go. I don't care if I have to do 10 conference calls from the putting greens, but this time we're going."

I wasn't trying to be ornery, but I'd been through this stuff before, and frankly, it had lost some of its luster. Sure, I knew Al and Sol were already angry with me and that my firm had $30 million riding on the deal. But, realistically, what value was I really going to provide at this point?

Tom and I both knew the analysts would sit around all weekend with their feet up on some DLJer's desk until around 11:00 on Sunday evening, at which point Sol and Joe, although they hated each other, would stroll into a conference room, oozing self-confidence and pretending to be blood brothers. What was the point of skepticism when the deal was done, definitive agreements were already signed, and *The Wall Street Journal* and *The New York Times* had already been spoon-fed the scoop? Most important, each of our firms was being

paid between $10 million and $30 million. Why would any of the bankers want a research analyst to ask any skeptical questions at this late stage in the game? Even I saw the downside of that one.

Tom, realizing I wasn't going to change my mind, confirmed my cell phone number and said good-bye, mumbling something like "I should have been an analyst." But despite everyone else helping Joe and Sol get ready, both of them were in for another disappointment after the news crossed the wires on Monday morning. Global Crossing shares fell heavily, from $46.38 the day before the announcement to $26 over the next two months, while the other acquirer, Qwest, dropped 16 percent, US West fell 7 percent, and Frontier slipped 17 percent in the same period.

To Publish or Not?

By mid-July, it had been exactly four months since I had written anything other than factual summaries on Global, Frontier, Qwest, and US West. And although I had made what I thought was the best decision at the time, I was really beginning to suffer for it. I had been essentially mute on four of the major companies in my industry for months while my competitors, whether they worked for the banks involved or not, continued to speak out. The Merrill salesmen and my clients were calling me all the time looking for some guidance on these falling stocks, and I couldn't say anything during the most important period of the year for me—the time when the *I.I.* votes were cast.

I felt more and more anxious. What the others were doing didn't seem right, but clearly no one was objecting to it, and I, as the lone holdout, was the only person paying the price. So in a move that now looks blatantly inconsistent, I decided to resume coverage of Qwest and US West. I issued reports on each of them with Accumulate, or "2," ratings, on July 21.

My earlier conversations with the lawyers didn't really play into it at all, at least not at first. I liked the way the two deals had ended up. In the Qwest–US West deal, I thought the decision to dramatically cut US West's dividend was wise, since it freed up money to invest in cell-phone service and high-speed Internet access, among other things. Plus the stocks had fallen so far that they were now good values. Based on my models, I saw Qwest shares rising as much as 33 percent and US West's 28 percent.

But I wasn't totally sanguine either. "Our rating is Accumulate instead of Buy," I wrote. "Despite such attractive upside, we anticipate the usual pressure from short-selling arbs and the approximate one year wait until merger close. We are also concerned about increasing wholesale [long distance] pricing pressure and new initiative startup costs at both companies."

Megan and I immediately started to work on a similar report on Global Crossing and Frontier. But, within a few days, I began to have second thoughts. Merrill was going to make about $20 million, but most of the fee depended on the deal actually being consummated. Since the shareholder votes hadn't yet happened, it occurred to me once again that perhaps I shouldn't be writing about any of these four companies. My opinion, if positive, could be interpreted as trying to influence shareholders to vote yes on a deal that Merrill had millions riding on. I asked the compliance folks about it, and they reminded me that I was cleared to write whatever I wanted thanks to the SEC's No-Action Letter.

But I quickly realized that regulation or no regulation, I had just violated the principles I had so steadfastly held to back in March when this particular four-way M&A episode got started. I began to fear that my clients might think my report was not an honest one, and that it was somehow tainted by the interests of Merrill's bankers.

So I made yet another arbitrary decision. Though I couldn't undo the Qwest and US West reports and their Accumulate ratings, I told Megan to stop working on our resumption of coverage of Global Crossing and Frontier until the shareholder vote was over. As with every move an analyst makes, this decision translated to someone important being unhappy. This time it was Global's chairman, Gary Winnick, and his CFO, Dan Cohrs. They were outraged that while many analysts were writing bullish reports, I hadn't yet published an opinion or forecasts for either Global Crossing or Frontier.

Then there was the fact that I had already written such reports about US West and Qwest. My position was obviously contradictory. After all, Global had hired Merrill to be advisers. Wasn't it reasonable to expect some support from their friends? Gary scheduled a meeting with Dave Komansky, Merrill's CEO, and the bankers told me the lack of research "support" would probably come up. Although Dave never said anything to me about Gary or Global Crossing, I felt that I was really pushing it this time.

So here I was, having set the wrong precedent by writing on the

first two companies and now trying to defend my decision to *not* reinstate coverage on the other two. I had ignored the shareholder-vote conflict issue in one case and now was invoking it along with my integrity in another. It was pretty inconsistent. Logic suggested that I should publish on the second deal just as I had on the first. On the other hand, two wrongs didn't make a right. So I decided to stick to my guns and not publish until after the Global Crossing and Frontier shareholder votes were complete, which fortunately was just a few months off.

In September 1999, after the Global Crossing–Frontier deal had been approved by both sets of shareholders, I resumed coverage of Global Crossing with an Accumulate rating. By the end of the year, investors' negative reactions to the deals had dissipated in the ongoing frenzy for Internet and telecom stocks. Global Crossing shares bounced back to $50 per share, not as high as the $64 they had reached on May 13 but still more than double the $23 they had traded at a year earlier. And Qwest shares had recovered, too, to $43 per share, down from a mid-April high of $48 but still up 72 percent in the last year. Not bad for companies that had gotten into a bidding war, generated enormous shareholder confusion and anger, and had turned themselves inside out from pure Internet startups to schizophrenic hybrids now owning both new-and old-economy assets. I felt a bit schizophrenic myself.

7. The Leak, the Ambush, and the Dupe

1999

The contract was ready for signing. All I had to do was put pen to paper and I'd have a nifty $1.5 million bonus that I hadn't even expected, in addition to having doubled my pay. It was truly surreal. The most surreal thing of all was the fact that the bank would never even miss it. A mere $1.5 million? For CSFB, it was a blip, nothing more, nothing less.

"Shame on Them?"

IN THE FALL OF 1999, *Institutional Investor* magazine published its annual ranking of the All-America Research Team, along with a cover story looking at the trends in the research business and the changing role of the research analyst. For the third year in a row, I was the second-ranked telecom analyst, behind Jack Grubman. I wasn't surprised at all: he was not only the best-known analyst in telecom but also the best-known analyst on all of Wall Street. Some hated him, some loved him, but everyone listened to what he had to say.

And if you really listened to what he said, it was pretty amazing. *I.I.* interviewed Jack as part of its cover story, and he was proud to speak out, a man at the top of his game. He made no apologies for his aggressive actions in favor of the companies he liked, as well as his role in helping Salomon Smith Barney's bankers land some of the biggest deals on the planet.

"Though some money managers grouse that they can never get him on the phone because he's so busy helping out on deals, many more rave about the connections he's made with top telecom company executives from all that deal making," the magazine wrote.

Jack's response was bold, even for him. "'The role of the sell-side has changed so dramatically. You try to do your best to stay objective, but it's becoming an increasingly difficult challenge,' says Grubman,

stressing that disclosure of potential conflicts to clients is essential. 'They know when I have an ax to grind—I tell them. There are known conflicts and potential land mines. But anyone who steps on one, it's really shame on them.'"[1]

Earlier that year, Jack even announced proudly to a rival banker that "when it comes to Bernie and me, there's no Chinese Wall." He also sent a blast voice mail to upward of 1,000 buy-side analysts and money managers mocking a competitor at PaineWebber who had predicted that WorldCom would end up acquiring Nextel, a wireless company, despite the fact that negotiations had recently been broken off. "I was there and I didn't see [the PaineWebber analyst] there across the table," he bragged. "Believe me, these companies are not getting back together. This deal is dead!"

Jack was simply rubbing all of our noses in the fact that he was on the inside of these negotiations and the rest of us weren't—so how could any of us predict the future better than him? *The New York Times* published a short article summarizing the voice mail and, once again, I figured Arthur Levitt's SEC would now be propelled into action, even if it hadn't before.[2]

This was typical Jack: brash, arrogant, reckless, and—literally—daring. He was daring the authorities to catch him. Jack seemed to feel he could tell the world that he knew what he was doing was dangerous and possibly wrong, but somehow he felt he was so clever that he could fly above the fray. Shame on them?

The $14 Billion Leak

On September 8, 1999, about 200 Wall Street investors and analysts who covered the telecom sector arrived at the Kansas City Hyatt for an all-day meeting with the management of Sprint, the $80 billion telecommunications giant. The meeting had kicked off the evening before in the hotel's ballroom with a dinner and a keynote speech by Sprint's longtime CEO, Bill Esrey.

I managed to get a seat next to Bill. Also seated at the table were eight other analysts. Some were from the sell-side like me, and others were buy-siders from money management firms and large pension funds. As we dined on filet mignon and poached salmon and sipped red wine, it was business as usual for me: find out what was going on at Sprint and then turn that edge into value for my clients.

We had about 30 minutes before Bill Esrey was scheduled to speak

to the entire room, so we jumped right into it, each of us eager to sneak in a few questions that might tease out a little information about how the numbers were looking and what strategic moves Bill might be contemplating. Virtually all of Sprint's competitors had been caught up in the epidemic of M&A activity. So when the conversation turned toward possible mergers or acquisitions on Sprint's part, we all leaned forward in our chairs. Would it be better, I asked, for Sprint to partner with a Baby Bell such as Verizon or BellSouth, or to merge with a foreign-owned company, such as Deutsche Telekom? Bill gave the expected pluses and minuses of each, seeming to lean away from both moves. As often was the case with Bill, who seemed to hate analyst meetings, he was just vague enough to give us nothing to go on.

Finally, I threw out the question none of us expected a serious response to: might Sprint consider merging with another long-distance company, like AT&T or MCI WorldCom? It was a very unlikely scenario, since it would certainly set off alarm bells in the world of antitrust, and since Bill himself had often slammed WorldCom as a poorly managed company. So I was surprised to hear him suddenly launch into a discussion of the pros and cons of a WorldCom–Sprint merger. He remained firmly in the theoretical, but it seemed—to my ears at least—that the pros outweighed the cons. Bill said the cost-savings would be huge. When probed, he said he didn't think the government should oppose such a merger on antitrust grounds. Uncharacteristically, he didn't even criticize Bernie Ebbers and the rest of WorldCom's management. It was odd to hear the usually reticent Bill Esrey entertaining such an idea at all. He wouldn't really consider such a move, would he?

We all wanted to press him further on this, but just then our private time was over and it was time for Esrey's speech to the entire group. He bounded up on stage with the energy of a fit ranch hand, his bald head reflecting the bright lights. With a slight lisp, he delivered an upbeat outlook for the company, projecting that revenues would grow 20 percent per year for the next three years, propelled mostly by Sprint's wireless PCS unit. He said nothing about any possible deals.

When the speech was over, my tablemates and I went out into the lobby for a break. Suddenly, the cell phone of one of the buy-side analysts rang insistently. It was a banker friend, calling from Germany, he said, who had heard a very specific rumor of a coming Sprint–WorldCom merger that would give Sprint 0.94 shares of WorldCom, or about $70 for each Sprint share, more than 50 percent

above its current price. If true, it would be enormous, the biggest deal ever. My blood began to pump, fueled by a combination of fear, anger, and excitement. How could someone in Germany already know something that had not yet been announced? I strained to hear more.

As we left the ballroom and descended the steps to the hotel lobby, we saw Jack Grubman coming through the front entrance of the hotel with two telecom analysts from two of the world's largest mutual fund groups. Shoulders hunched in his oversized, double-breasted suit, he projected the cocky confidence of a man who knew billions hung on his every word. Jack and the two buy-siders had gone out to eat, intentionally missing Bill Esrey's speech and, of course, the chance to pick Esrey's brain at dinner. How could they afford to skip out on these opportunities, which, after all, were the analyst's bread and butter? To skip the dinner and the interaction with Esrey and Sprint's top executives meant they must have felt pretty confident about their own abilities to predict the future. Or perhaps they simply felt that their powers of prognostication would gain far more from two hours with Jack Grubman.

Agitated, adrenaline on overload, my buy-sider friend spotted Grubman and homed in like a heat-seeking missile. "I'm going to ask Jack," he said. "Since this involves WorldCom, if it's real, he'll know for sure." He assumed that Salomon would be doing the banking and, therefore, that Jack might have gone over the Wall. About 30 minutes later, I ran into the investor at the hotel bar. "Dan, Jack says those numbers are exactly right: 0.94 WorldCom shares for each Sprint share."

The specificity of the rumor—and Jack's confirmation of it—staggered me. Nothing had been announced. How could Jack know the exact ratio of the deal? Had a Salomon banker or someone from WorldCom tipped him off? Had he been over the Wall and decided to share what he'd heard?

Suddenly, I had two big problems. First, I had a Neutral rating on Sprint's stock. If the rumor was true, I would look pretty bad, since Sprint's shares would trade way up once the deal was announced; $70 was a huge premium to Sprint's current $46 stock price. Should I upgrade my Sprint rating based on what I had heard? It was only 9:00 PM and I had all night to write it up, get it approved by Merrill Lynch's compliance department, and announce it to Merrill's brokers the next morning. I would look brilliant if the deal was ultimately announced.

But there was a second, much bigger problem with that. If Jack's confirmation was based on inside information, now I, too, was in possession of it. If I upgraded the shares, I could be using that inside information illegally. On the other hand, people traded on rumors all the time. Maybe Jack and these guys were simply dealing in gossip, which to my knowledge wasn't illegal. But this seemed like too big a leak in too big a deal. Surely, it was going to be the one that would finally get someone busted. I left my Neutral rating in place and decided to take my lumps if the merger actually happened. Better to be wrong than in stripes.

It took sixteen days for *The Wall Street Journal* to sniff out the rumor. On September 24, *The Journal* printed a story speculating that WorldCom and Sprint executives were discussing a merger, causing Sprint shares to jump almost $4 or 8 percent that day. But the two stocks had already moved and some investors had already profited: in the sixteen days before the *Journal*'s "scoop," Sprint shares had risen by a total of $5.4 billion, or $6 3/16 per share; and WorldCom shares had dropped by $1.9 billion, or 93 cents per share. And the market value of Sprint PCS, also likely to be acquired in the transaction, rose $6.4 billion, or $6.75 per share during the same 16-day period.

Together, that added up to a total of $13.7 billion of shareholder value that had changed hands, with some investors winning thanks to their inside information and others losing thanks to their lack of it. If you or your mutual fund sold shares of Sprint during that time, the buyer of your shares may have been armed with an unfair edge. Alternatively, you or your fund manager may have bought shares of WorldCom without realizing what the seller may have known—that WorldCom shares would likely fall once the deal was announced. You'd been cheated without knowing it. After the article appeared, another twelve days passed before the deal was officially announced—at, yes, exactly the ratio that the investor had heard and Jack Grubman had confirmed. It was clearly old news for some big players.

It was indeed the biggest deal ever announced in the history of Wall Street, and not only did Jack Grubman know about it beforehand but, it appeared, so did at least one of the world's largest money management firms. It had happened again. But this time, the leaker had given four weeks' notice, rather than the three days' when Global Crossing bought Frontier or the 15-minute heads-up given when Frontier bought ALC.

Of course, it was impossible to know where the original leak had come from. It was equally impossible to know whether Jack had

obtained this confidential information while over the Wall—that is, while he and Salomon Smith Barney were advising WorldCom in the negotiations with Sprint. Perhaps he was merely passing on a rumor that someone else had passed to him. But if he had been over the Wall, it was a suicidal move, I thought, given that there had already been an internal investigation at Salomon over his compliance issues. I had also heard whispers that the SEC had been preparing a big file on him. With *The Wall Street Journal*'s critical pieces about him in 1997 and the one about Level 3 a few months earlier highlighting the conflicts of interest between his research recommendations and his banking maneuvers, I felt certain that his every move was being tracked.

A few months earlier, I'd received a call from a *Forbes* reporter who wanted to write a story on how some analysts might be using advance information to their advantage as well as promising bullish research on a company's stock in exchange for that company's investment banking business. I gave him some ideas to pursue and names of people to call, stressing that I wanted to remain off the record. I hadn't heard back from him by this time, but with all these questions percolating, I figured it was only a matter of time until Jack got what was coming to him. I told Paula, for what felt like the tenth time, "Well, he's finally tripped the wire. If he's breaking the law, it's just a matter of days now."

The Ambush

In the meantime, my relatively skeptical reports and opinions apparently weren't playing well in the executive suites of Merrill Lynch. As Salomon continued to win the lion's share of telecom deals, David Komansky, Merrill's CEO, couldn't help but notice. Merrill had, earlier that year, hired Henry Blodget from Oppenheimer & Co. as its Internet analyst after his outrageous call that Amazon.com would go to $400 a share came true and anointed him the hottest name in Internet stocks. Although Merrill still lagged several other banks, the banking that had begun to flow Merrill's way as a result of his hiring made it all the more obvious that this wasn't happening in my sector.

As more and more companies went public, there were more and more companies to cover. While our telecom team had expanded to six people to meet the demand, there were certain companies, like Level 3 and other dot-com types, that just weren't going to be covered by me—partly because I didn't have the time, partly because I thought they were overinflated blobs of nothingness and not necessarily

telecom companies. This frustrated Merrill's bankers and executives, of course.

Although I didn't hear this story until years later, in the middle of 1999, David Komansky had a meeting with Tom Davis, who ran Merrill's investment bank and reported directly to him. Komansky apparently complained about Merrill's low market share in telecom investment banking deals and asked what exactly was causing it to lag so far behind SSB's. I don't know if the words "Why can't Dan be more like Jack?" were ever uttered, but that apparently was the strong implication. Salomon was cleaning up in the telecom sector, and Merrill wasn't. David Komansky, naturally, wanted to rectify the situation.

I was beginning to feel increasingly out of step with the Merrill team—and with the evolving role of the analyst, if what that meant was that I had to be like Jack. But I was hardly about to quit. I still viewed my job as the best in the world. It was lots of fun, intellectually challenging, and brought personal dividends from press quotes, mentions on CNBC, and the appreciation of my team and clients. My job was also outrageously well-paid, and I had a contract that in 1998 had been extended through 2000 with a fixed sum regardless of how much telecom banking work Merrill did, or whether I made it onto the *I.I.* list, or how my stock picks turned out.

I still loved the essence of the job: my team, debates with clients, and the adrenaline rush during breaking news events. Since I'd started at Merrill, I'd hoped to take early retirement at 50, and now, at 46, I still had a way to go at a time when the once-rational market had reached heights that none of us could ever have imagined. By September 1999, the Dow Jones industrial average and the NASDAQ index had more than tripled from the end of 1992.

A few months before the Sprint meeting, back in June of 1999, Andy Melnick, Merrill's director of research, came to me with a proposal to hire Tim Weller, one of Donaldson Lufkin & Jenrette's telecom analysts, to work side by side with me. The idea was simple: he could cover some of the newer stocks that I wasn't interested in covering or didn't have time to cover. I had met Weller a few times at analyst meetings over the past year or so and thought he was extremely bright and funny.

I also had a fond memory of Tim from three years earlier, when Jack Grubman sent out the report bashing Merrill's and my integrity and claiming that MFS was so much better than Teleport. Tim backed

me up. His report said: “Our friend Jack Grubman has pointed out a few reasons why he feels MFS is a better company than Teleport. Since Jack has a fondness for hyperbole, we offer a few counterpoints to keep him honest.”

With a PhD in electrical engineering from the University of Illinois, where he studied with Mark Andreessen, the inventor of the Web browser and a co-founder of Netscape, Tim was one of the very few people on my side of the Street who could claim to understand the Internet. Perhaps for that reason, he was much more positively disposed toward the smaller dot-com telecom companies than I was.

One thing Tim wasn’t, however, was *I.I.*-ranked. The *I.I.*-ranking had always been the yardstick by which all of us were measured, on the assumption that without a high *I.I.* rating investors wouldn’t follow our advice and thus companies wouldn’t hire our firms for big deals. Merrill’s consideration of Tim made me wonder if this equation was beginning to change, favoring analysts who could convince investors to buy new-economy stocks, regardless of their ranking on some silly old-economy survey.

Although I found the idea of another telecom analyst—particularly one who didn’t report to me—a bit threatening, on the face of it Andy Melnick’s idea made sense, and I thought it might work out fine. If he covered some of these stocks that I had refused to or that fell outside of my traditional coverage, that would lighten my team’s workload. It also meant Tim—not I—would have to deal with the crazy valuations the market had put on some of these Internet-related startups. And, of course, he would have to deal with the deal-crazed bankers trying to ramp up Merrill’s share of technology and telecom deals.

So Tim came to our offices to meet with Andy and me, and everything was going smoothly until we started talking about stock coverage. Tim said he wanted Level 3 and Qwest as well as the Internet-type companies that I hadn’t been covering anyhow, some of which I hadn’t even heard of. They all made sense to me except for Qwest. “I’d love to get Joe Nacchio off my back, but it’s a core company for me,” I said. “Qwest is buying US West; it’s a Bell company far more than it is a dot-com or Internet company.”

I went home and started to think that maybe there was something sinister going on here. Most distressing to me was the possibility that Merrill wanted to transfer responsibility for some of the stocks I covered to an analyst who might be more bullish. It sure began to smell funny. The more I thought about it, the more I worried. Why

would they bring in someone of Tim's caliber if they intended for me to stay? Was a palace coup in the works, an ambush meant to ultimately push me out the door?

Of course, they would still have to pay my salary and bonus through the end of 2000, but next to the potential banking fees, that would be a pittance for Merrill. It was a very neat way around the problems I was causing: simply bring on a bull who didn't have any of my issues or concerns and give him coverage of the hot, deal-making companies such as Level 3.

But I felt a lot better when Rosemary Berkery, Andy's co–global research director, came to me a few weeks later and asked if a new, extended contract would make it easier for me. I said it was a possibility, but only if my coverage list was protected. Otherwise, I pointed out, investor clients and salespeople would see it as a signal that my responsibilities were being reduced, which in turn, would hurt my ability to compete for attention and votes.

So a few days later she came back to me with a new three-year contract that took me through Spring 2002. It explicitly stated that Qwest could be taken away from me if Merrill hired a new senior-level analyst. It was a switch from my prior contract, which had said that Merrill couldn't reduce my responsibilities unless it was willing to pay out my contract in full and send me on my merry way—not an entirely unappealing scenario.

I upped the ante a bit, asking Rosemary, a serious, hard-nosed professional who later became Merrill's general counsel, to make it a four-year deal, one that would take me to my Spring 2003 early retirement target date. She said yes—if I would agree to an exception that allowed Merrill to hire an analyst "with responsibility for companies engaged in Internet applications plus Qwest, Level 3 and up to two other companies engaged in or entering into similar businesses." This meant Merrill could take away the new economy's hot highfliers, even Global Crossing, but they couldn't take any of my core companies, such as AT&T, WorldCom, or the Baby Bells, and that satisfied me.

Yet it was all for naught. It turned out that Tim Weller wasn't quite as interested in the job as he'd said he was. In August of 1999, he accepted the CFO job at a red-hot Internet startup called Akamai Technologies. When it went public at the end of October, Weller was suddenly worth over $300 million on paper, making whatever he'd

been negotiating for at Merrill a joke, at least until Akamai's stock later collapsed. On the other hand, if he had come to Merrill and taken over coverage of Qwest shares, it would have worked out a lot better, certainly for me and possibly for both of us: within two years, Qwest would become my most disastrous stock pick.

Still, the whole saga kept me on edge for a while. I knew Merrill couldn't and wouldn't fire me, as it would be a public relations nightmare to do so without any poor performance or wrongdoing on my part. The press had already been publishing pieces about the growing conflicts between analysts and bankers, and I knew several journalists who would love a story like this one. Plus Merrill would have to pay me. But I couldn't stop worrying. What did all this mean?

A Piece of the Action at CSFB

A ringing telephone quickly put an end to my anxiety. On the line was Al Jackson, global head of equity research at Credit Suisse First Boston. I didn't know Al, but I did know that CSFB was a long-established investment bank that had hit hard times a few years earlier. It was now experiencing an amazing revival, thanks in large part to my old colleague Frank Quattrone.

CSFB had recruited Frank in 1998 from Deutsche Bank and now controlled the lion's share of the technology and dot-com IPO business in Silicon Valley. But CSFB had lost its well-regarded telecom analyst, Frank Governali, to Goldman Sachs earlier that year and had apparently struck out with everyone they'd tried to hire. They hadn't even thought of contacting me, since they believed I was very satisfied at Merrill. But nobody knew the real story.

The call followed that beautiful script, and I was pretty jazzed to hear it.

"Dan, I'm sure you're happy and Merrill is taking care of you," Al said, "but I figured I'd go for a long shot and see if you wanted to talk. We are thinking big numbers."

I played it cool. I told Al that I was very loyal to Merrill, but that, like any good analyst, my mind was always open to new information. He told me what kind of money they were thinking about, which, it turned out, was close to where I already was. I told him so. "Tell you what, Dan," he said, with disappointment in his voice. "Let me talk it over with some folks here and I might get back to you." I figured that was the end of it, since they surely thought that Merrill would match

anything CSFB offered.

To my surprise, Al called back a few days later and said he had gotten approval to talk to me about "much higher levels." He invited me to have dinner with him, Chuck Ward, the co-head of the investment bank, and Brady Dougan, who was then the global head of the securities division and today runs CSFB. It turned out that CSFB had been courting a few other analysts who they thought might be ready to move, but had ended up only accelerating their spiraling pay packages. One was Blake Bath, who went back to Lehman and managed to double or triple his salary and bonus. This call, Al said, had been a shot in the dark. "We know Merrill will never let you go," he said.

So one evening in mid-September, I slipped into the CSFB building, the art deco former Met Life building at Twenty-fifth and Madison, and headed up to the executive floor, where a private dining room had been reserved. Al, Chuck, and Brady greeted me warmly. Al Jackson was a thin, kind, unassuming guy who had once been an analyst and had survived as research director through multiple management changeovers. Chuck Ward was a very serious, all-business type who from the first meeting was focused entirely on one thing: profits. He was a banker's banker. Brady Dougan had been a derivatives trader, and he still carried that mentality, working 14-hour days and not bothering to smile (it wasted time and energy). Brady's tie was always askew, as if his body had been struggling to stay in its suit all day and was on the verge of giving up.

The pitch was the same pitch I'd heard in the past—we love telecom, we want to make it a huge part of our franchise, blah blah blah—but there was a twist: these guys actually had something to leverage. They wanted to play off of their incredible momentum in the technology business, momentum that had bounced into their lives with the arrival of the inimitable Frank Quattrone and his team from Deutsche Bank. Frank Quattrone's organization handled everything from investment banking to brokerage for wealthy individuals to, yes, research, and had vaulted CSFB to the top of the league tables in the technology sector.

I had heard from other sources that Frank and his group had a "piece of the action"—that is, the group's compensation was an explicit percentage of the profits his group generated. Fifty percent was the rumor, but it turned out to be 33 percent of any revenues the group brought in over $150 million. In 1999, Frank's group brought in $600 million, which meant Frank ended up with $150 million to

divvy up between himself and his staff. Between 1998 and 2000, according to the National Association of Securities Dealers, Frank would personally rake in over $200 million.[3] At the time, I didn't know what the numbers were, however.

The dinner went well, and was followed by a 7:00 AM breakfast a week or so later at the Soho Grand Hotel, a great place to meet because Wall Streeters never went there, particularly not at 7:00 AM. My general sense was positive. I thought they were extremely serious about supporting me and bringing my team over with big raises as well, which was a critical part of any deal. I figured I was in a no-lose situation: with the new contract at Merrill, I was well protected from banker pressure, and if I got an offer from CSFB, I'd take it to Merrill and see what happened.

About midway through the breakfast, Brady Dougan pulled out a one-page set of sample contract terms. It offered two choices: one, a fixed contract like the one I had at Merrill but with a raise of about 60 percent, and another with some very unusual incentives. The men had hinted at something similar to Frank's deal, and it turned out that they were willing to give me a percentage of any new telecom deal fees that CSFB landed in the sector.

I was stunned. I was an analyst, not a banker, yet they were proposing that I be paid on commission, just like a banker was. I would get a piece of whatever deals I brought in or indeed of any telecom deal at all, which seemed to create an obvious incentive to make my recommendations more bullish than they would otherwise be. If that happened, I'd be putting my financial interests first, ahead of my clients'. Was this the way others were being paid?

I was taken aback, but decided that, as in all negotiations, there are times when it is simply better to listen than to talk. The breakfast ended with Al Jackson promising to get me a draft of the full contract within the next few days and me agreeing to meet more CSFB executives the following Friday.

So on October 15, I told my executive assistant, Connie, and my team I would be working from home and spent a whole day upstairs in CSFB's private dining room while the head salesmen, traders, and others came upstairs to meet me. I really liked everyone, and their we-try-harder enthusiasm appealed to me a lot. The next Monday afternoon, I returned one last time for a meeting with Ernesto Cruz, then head of U.S. equity capital markets, which is the department that gets the IPOs done by running the road shows, and pricing and

allocating the shares. We talked about the conference I'd been running at Merrill, which was of great interest to CSFB. Ernesto asked me how much I spent on the conference. When I told him $1 million, he laughed. "Frank spends over $2 million on his," he said, referring to Frank Quattrone's over-the-top technology-investor conference held each November at the swanky Phoenician Resort in Scottsdale, Arizona.

Frank's conference, which he had successfully moved from Morgan Stanley to Deutsche Bank and then to CSFB, was the most exclusive of all investor get-togethers, an absolutely sizzling ticket. In November of that year, Robin Williams would show up and perform for free—just because he was an investor in one of Frank's client's funds and wanted to get in the door! Wow, I thought. I could throw one hell of a party with $2 million.

Finally, Allen Wheat, CSFB's CEO, came in. Allen seemed to be a lot of fun, a motorcycle-riding New Mexico native who was extremely approachable and seemed sophisticated. He was very different from the street-smart David Komansky. He gave me the standard talk about how important telecom was and then mentioned how he liked to hire the best and let them do their job without interference. Now that was music to my ears. At first, I thought he meant he didn't allow anyone to interfere with research analysts' opinions. But it turned out he wasn't talking about research. He was talking about giving his bankers and traders the freedom to make money any way they wanted to, as he did with Frank Quattrone and others.

While I was trying to figure out what to do, I was surprised, and I guess a little bit flattered, to receive a call from Frank. I hadn't spoken to him since we were both at Morgan Stanley, but certainly life had changed for both of us, particularly him. Frank had become arguably the most influential banker in the entire world by now, the Jack Grubman of banking. Frank had more money and more power than just about any employee of an investment bank, and as a result, people were awed by him.

None of that came up on the call, however. Frank made nice, acknowledging our common heritage at Morgan Stanley and telling me how much progress CSFB had made in the previous few years. He said that the technology group was anxious to work closely with the telecom group. It was a natural fit, he said, because the big telcos were such huge users of technology and telecom equipment. The tech companies he handled, such as Lucent, Cisco, and numerous Web startups, would love to have better information flow about the

telecom service companies and certainly would want their investment banker to be able to make introductions. On my end, I figured that I could gain from this cross-fertilization as well, by its making me better prepared to predict how new technologies, particularly the Internet, would impact my companies going forward.

He sounded incredibly open and friendly, and I had never had any sort of run-ins with him in the past. But I couldn't help but wonder whether he might somehow try to influence my research. This worried me a lot. I remembered that *Wall Street Journal* piece back in 1992, when both of us were at Morgan Stanley, describing his attempts to influence a research analyst's opinion. I found it hard to imagine he'd be more hands-off now.

While I was mulling this over, a FedEx package arrived at my home. Inside was the draft contract Al had promised at our last breakfast. Instead of a fixed salary and bonus, CSFB was offering me a piece of the action: 2.5 percent of any telecom fees earned by CSFB above $150 million per year. As long as a telecom company anywhere in the world paid CSFB a fee after that point, I would collect my piece. I didn't even have to cover the company myself: if CSFB underwrote a bond offering for Korea Telecom, advised France Telecom on an acquisition, or managed the IPO of an Internet service provider, I would personally reap 2.5 percent of the fees earned.

Given the current rate of IPOs and deals that the bank was bringing in, this had the potential to be one amazingly lucrative offer. A doubling of CSFB's telecom investment banking business to $300 million in the next year, for example, which was entirely possible, would mean an extra $3.75 million in my pocket. There were also payments for an *I.I.* ranking of number one, two, or three and additional incentives if CSFB ranked in the top five spots in three different league tables: telecom M&A, telecom stock underwriting, and telecom junk-bond underwriting. At our last breakfast, I had suggested some sort of bonus tied to the performance of my stock recommendations. Oddly, that was the one incentive that didn't show up in this letter. Clearly the big money was coming from the banking.

No one was home when I opened the letter, but I somehow felt guilty. I half expected someone to jump out from a closet and start wagging his finger at me. If there ever was a way to codify a conflict of interest, this letter sure was it. I wondered if I should even bother dancing with these guys. Was Merrill's subtle disappointment with me going to look like paradise in retrospect if these guys at CSFB were so

focused on paying me like a banker? On the other hand, the financial upside might be dramatic. Was this the temptation that would send me to the other side?

I wanted to see Paula's unbiased reaction to these enormous numbers. Careful to keep a straight face, I gave her the offer letter. After reading the relevant paragraphs, it took her about five seconds to make up her mind. "This looks like a huge conflict of interest. No way you can take it," she said, as clear-minded and matter-of-fact as always.

Brady, Al, and I met again on November 5, this time at the Mark hotel, where I had met with John Mack back when he was trying to lure me back to Morgan Stanley. I couldn't help but look furtively around for him or anyone else who might recognize me. I told them my lawyer (always blame the lawyer) had advised me to request that four items be added to the contract.

The first was that I wanted my team and me to report to Al. I did not want to report to Frank Quattrone. I was sure that having a banker as a boss would create more pressure than ever to be bullish on the stocks I covered. Brady said "fine." Al smiled. He was clearly relieved that telecom stocks would remain under his watch. Upon Frank's arrival a year earlier, the analysts covering technology stocks had moved under his direct control. Whatever faint line still existed between those analysts and the bankers seemed to have disappeared into the sand. I had no intention of that happening to me.

The second item related to my team. I wanted to bring over six of them at roughly the same percentage pay increase as I was getting. Al said no problem. He was impressed that I had been able to assemble and keep such a highly qualified team. He said he could give each a two-year contract, but I wanted four years to match mine. Brady said they had never gone past three years and wouldn't do it now. They had finally said no to something. I protested, but in the end, we compromised. All six received three-year guarantees.

The third item was more of a stretch. I requested a guaranteed minimum budget for my staff in terms of both headcount and aggregate compensation. This was extremely important because it would enable me to protect my team even if hard times hit CSFB. Brady had no problem with the concept.

The final item I held for last because it was the most important

and I didn't want to bring it up until everyone thought the deal was done. It was that incentivized bonus scheme. "I'm good to go on virtually everything," I started. "Except my wife and I had a long talk. She's just not comfortable with the banking incentives and I agree. So I'd like to go back to the fixed deal, but, given how the incentives have gone up, can we increase the annual fixed amounts by 25 percent to equalize the two offers?"

I expected some kind of reaction, at least surprise that I would reject something that could make me so much dough. I was rejecting a contract that would have paid me as much as 40 percent more than the fixed contract would over the four years. But the CSFB guys were true pragmatists. They didn't care what I did as long as I decided to come with them. Fine, they said. What ever works for you is fine. And the 25 percent? That's fine too. I'd learned a few negotiating tricks along the way, I guess.

At the end, I had what amounted to a doubling of my pay package from Merrill and roughly the same for the members of my team. It was truly crazy. My contract had no upside opportunity for banking, for making number one on *I.I.,* or even for picking stocks well. Likewise there was no downside risk even if the bankers—or their corporate clients—were not happy with my investment opinions. Even if my *I.I.* ranking fell or if I fell off the list entirely, I would still be guaranteed the same amount.

Yet there was no way I was going to start slacking off. I wanted to go out on top and beat the Grubster, as my team members liked to call him. It was going to take a lot of work, since he ruled the roost in virtually every constituency, from executives to buy-siders, from journalists to bankers. I figured the world would have to wise up at some point.

I was 90 percent sure I was going to move, but the decision wasn't final. I still had to find out how Merrill would react. So on the night of November 16, after my lawyer had signed off on the final contract changes, I left Andy Melnick a voice mail saying I needed to speak with him as soon as possible the next morning, which was a Wednesday. By the tone of the call, I knew he would know what I was calling about.

Merrill: I'm Outta Here

At this point in the bull market, research directors like Andy were fielding these gun-to-the-head stickups about every week or so. Did

they want to keep this analyst? Was it worth doubling his or her comp to do so? The amount of money being spent on salary, bonus, stock options, and the like was simply staggering. The only thing more staggering was the amount of money coming in from the bankers' deals.

In 1999, for example, Merrill would earn $2.6 billion in profits, up a mind-boggling 69 percent from the year before. Its revenues from investment banking alone were $3.6 billion, while Goldman Sachs's banking revenues were $4.4 billion and Morgan Stanley's $4.5 billion. Credit Suisse First Boston, fueled by Frank Quattrone's technology IPOs, brought in $1.9 billion in fees. It was truly raining money.

That evening, after leaving Andy that voice mail, I couldn't help thinking how nice it would be to get away from Merrill's massive retail system and to get back to a firm that serves professional investors only. For the past six and a half years, I had avoided direct contact whenever possible with Merrill's brokers and their clients, mostly out of necessity. Dealing with retail, or the brokers who interact with individual investors, takes far too much time, distracts you from doing research, and siphons off time that otherwise might be used to serve institutional clients and win *I.I.* votes.

I had come to realize that dealing with retail was a loser's game. If brokers bought a stock and it went up nicely, we never heard from them. If it went down, on the other hand, we got nasty voice mails and e-mails screaming about our bad picks. But the main problem with retail, which wasn't specific to Merrill but was true of every brokerage firm with a large focus on individual investors, was that it dumbed down everything we did. Merrill's retail system, for example, had the ability to convert a report of 20 to 40 pages into a paragraph or two of Madison Avenue–style slogans, combined with some words about my "top" ranking as an analyst. The brokers would then push this simplified information through to their clients.

The other problem was that some brokers paid no attention to the risk level we assigned our stocks or to the need to diversify risk. They didn't look at our picks in connection with Merrill's investment strategists, whose job it was to recommend to investors whether they should be overweighted or underweighted in the sector, or whether investors should hold a certain percentage of their portfolio in stocks versus bonds versus cash. Caveats, alternative scenarios, and other details that my institutional clients read and took the time to understand never made it to the regular folks.

The brokers were enormously varied in their experience and smarts, and the most sophisticated ones ended up, unsurprisingly, with the individual clients with the highest net worth. Taxi drivers and teachers with a relatively small amount of savings were more likely to get the youngest, least experienced new residents of broker-land. And those brokers were the ones who seemed to blindly follow analyst picks most often.

So the idea of returning to a bank that served only institutional investors was really very appealing, especially when combined with the pressures I was feeling. I had had nearly seven good years at Merrill, but I was a realist: I was clearly wearing out my welcome with the bankers there, and a move to CSFB would give me a fresh start that I hoped would carry me through the three and a half more years I wanted to stay in the business. I was sad that my time at Merrill Lynch had to end this way, but I was mostly relieved that CSFB's door had opened at exactly the right time.

The next morning, Andy's secretary asked me to come down to his office. Rosemary Berkery, who ran the research department with Andy, was there too. "Look," I said, "I have been very happy here, and I appreciate everything you two have done for me. But I have this offer from CSFB and I feel obligated to give you a heads-up." Andy asked what it was, and I ticked off the numbers for each of the four years.

Both of them looked startled, giving each other quick glances, but neither of them asked me what was wrong or what they could do to make things better here, as usually happens. Instead, they said they'd have to get back to me. That part was typical, since they needed approval from David Komansky, the CEO, to match an offer of this sort. As I exited Andy's office, I couldn't help wondering whether Andy and Rosemary were high-fiving each other as the door closed behind me.

The next morning, they called me in at around 9:30 and got right down to business. Rosemary led the discussion. "We think you're doing a great job," she said, "and we've made a commitment to you and we thought you had made a commitment to us." Translation: We're not matching. "I appreciate that," I said. "You guys have been very good to me. I know these numbers are crazy. Let me think it over and I'll get back to you later today." Translation: I'm outta here.

I have to admit I was surprised and a bit disappointed, more for my ego than for anything. Another side of me—the side that was a

shareholder in this company—actually felt a little relieved. I guess there are limits to this game of chicken, I thought. It was over. So I went back to my office, called Al Jackson, and told him we had a deal. This meant that he could immediately start calling my team, as I wasn't allowed under my Merrill contract to solicit them myself. Ehud Gelblum, a 30-year-old PhD in engineering who'd been working with me for just a year and half, was the most aggressive one of the bunch, and he knocked on my door. He knew something was up, having heard the buzz that traveled at lightning speed the second someone went into Andy's office. "Don't worry," I said. "It's good. Just hang in there."

I walked out the doors of the World Financial Center for the last time and went home, waiting for my team members to get the call to come to a meeting with Al at 7:00 PM, where they were offered pre-negotiated contracts. They were excited, but also worried and confused by the quick turn of events, so I was up until about 3:00 that morning, talking through the details with each of them. I explained that they wouldn't report to anyone on the banking side, that I would protect them, and that everything would be fine. Probably the toughest sell was Connie Marotta, my executive assistant, who had spent virtually her entire career at Merrill. But by the next morning, all of them had signed contracts and shown up for work at their new home, CSFB.

We spent that Friday and the entire weekend setting up our systems, working with CSFB's computer people, and meeting with its conference planners to try to transfer our conference, which was already scheduled for March, to CSFB. Three of us even spent Saturday afternoon visiting hotels and other conference venues, reviewing their facilities and available dates.

My departure must have set off a bit of a panic inside Merrill. I heard that within 24 hours of my leaving, several people, including my friend Linda Runyon Mutschler, the number one wireless analyst, had their pay packages instantly doubled. And despite my entire team's reputation for playing it straight, Merrill made a huge effort over that weekend to convince both Mark Kastan and Ehud to return. Ehud actually turned down an offer from Merrill that was twice what CSFB was offering. He told me he was worried Merrill's bankers would push him to recommend everything in sight. "I don't want to be a whore. It's just not worth it," he said.

Mark felt the same way. He had had some serious run-ins with the

bankers as well, some of which he didn't even know about.

"Any Idea What the Hell They Were Talking About?"

Earlier that year, Merrill banker Tom Middleton had asked me to come to his office for a meeting. I walked in to see Rob Kramer, a young, rising-star banker in Middleton's group who was assigned to a variety of telecom startups.

I immediately flashed back to a conflict I'd had with Rob about a year earlier. Ehud and I had gone with him to visit Digital Island, a San Francisco company planning an IPO that claimed to have a brilliant, proprietary technology for efficiently routing Internet traffic around the globe. At least that's about all I understood after a four-hour pizza and Chinese take-out dinner with Digital's top executives in their conference room.

It was late, the pizza was digesting, and I was exhausted, so maybe that's why I had no clue what they were talking about. We'd had a rough day, starting in New York, then flying to San Francisco for a meeting with Global Center, a Web-hosting company in Palo Alto, then with Covad, a DSL startup in San Francisco, followed by a meeting at PacTel (now SBC)'s DSL operations center in Walnut Creek before reaching Digital Island at about 7:00 PM. Or perhaps it was because I just wasn't equipped to understand the Internet. I kept scratching my head trying to "get it"—and also to stay awake.

As we walked out of the building, I said to Ehud, "Any idea what the hell they were talking about?"

"Nope."

"Ehud," I said, "you're a fucking PhD in electrical engineering. If you can't explain this thing to me over the next half hour, then there is no way we can put our names behind their IPO."

Merrill banker Rob Kramer was walking a step behind and started to panic.

"You guys, this company is awesome," he said. "Investors will eat it up. Get with it. This company is going to revolutionize the Internet and you can take credit for bringing it to [the attention of] investors."

"Rob, I sat in there for four hours with a PhD in electrical

engineering sitting next to me. I still have no idea if this thing is a sham or for real. I'm certainly not the guy who can credibly explain it to our sales force and brokers, or to investors. Shit, I can't even understand half the words they used in there. And, for some reason, I'm not even sure they did either."

The next morning, as our plane touched down at JFK, we all jumped on our cells to check messages. Rob had news: it turned out that Merrill could not underwrite this IPO even if it wanted to. This was because Merrill's private equity fund, a fund for managing directors and other executives that I had invested in as well, had recently invested in Digital Island. Since we had only recently invested, were we to be the underwriter, it would look like we had invested in order to get the IPO business and/or to hype the stock when it went public.

Everyone agreed, for a change, that this was a real conflict of interest. I was relieved. Eventually Digital Island did get its IPO done, in June of 1999, underwritten by Bear Stearns, at $10 a share. It was, to my surprise, a huge hit. It quickly rose to as high as $148 in December 1999. But then, like so many other dot-com startups, it crashed. (By 2001, it had found its savior, Cable & Wireless, which bought Digital Island for just $3.40 per share.)

Returning from my flashback, I heard Merrill banker Rob Kramer immediately begin to slam my colleague Mark Kastan's lack of influence in the markets and lack of respect among the top executives of the startup local carriers that he covered. "He just doesn't get it," Rob fumed, again saying how the Internet was changing the world and Mark was the last to realize it.

I understood that what he was really saying was that he didn't like Mark's measured research in comparison with Jack Grubman's orgasmic enthusiasm for the startup local carriers. Tom and Rob told me that they'd like my help in either convincing Mark to be more bullish or finding someone to replace him. I told them that Mark was doing a great job. Just like me, Mark couldn't be expected to "win" when Jack, it seemed, was using over-the-Wall information to gain influence. I said that I would not allow any change in Mark's coverage.

The $1.5 Million Mistake

But now I was leaving, and suddenly Merrill realized that having no analyst was a lot worse than having one that didn't listen to the

banking side. Mark received streams of phone calls all weekend from Rob, Tom, Andy Melnick, and even John L. "Launny" Steffens, Merrill's vice-chairman, a board member, and the second-highest-ranked executive at the firm. They all exhorted him to stay at Merrill. And Andy kept one-upping CSFB's offers. Mark never wanted to stay but did a marvelous job of negotiating that weekend, parlaying the competition into an even better offer from CSFB.

The irony was amazing: Merrill was desperate to rid itself of me and CSFB was equally desperate to hire me. And both were in heat for Mark and Ehud. In the meantime, the PR people at both firms worked to convince the outside world that Merrill fought hard to keep all of us. Merrill didn't want anyone to think it was pushing out the second-ranked telecom analyst, since that could make welcome fodder for an ugly article about banking pressures on analysts. CSFB, on the other hand, wanted to notch up another victory for this up-and-coming bank. *Investment Dealers' Digest,* a trade rag read by Wall Streeters, even reported on December 20, 1999, that, in the words of a "source familiar with the move," "'Merrill fought hard to keep Reingold….They tried to but couldn't keep him.'"[4] Yeah, right.

Several days after starting at CSFB, I was looking over my contract when I saw a number that stopped me cold. It looked as if CSFB had made a mathematical mistake. We had agreed to a deal that would compensate me for the unvested Merrill Lynch stock and options I had left behind. Amazingly, there was a $1.5 million error—in my favor!

The contract was ready for signing. All I had to do was put pen to paper and I'd have a nifty $1.5 million bonus that I hadn't even expected, in addition to having doubled my pay. It was truly surreal. The most surreal thing of all was the fact that the bank would never even miss it. A mere $1.5 million? For CSFB, it was a blip, nothing more, nothing less. But I couldn't keep it. I told Paula the story, and she agreed that I had to give it back.

So that evening, I left CSFB's Brady Dougan a voice mail. "I want to let you know there is an error in the final contract. The make-whole award is $1.5 million too high by my calculation," I said. I figured Brady would forward my message to the right people and then send me a quick response, saying something like "Thanks, Dan. You are an honorable man and you are already making CSFB proud." But there was no response. A few days later, a new contract arrived, exactly $1.5 million lighter.

I never heard a word about it, not from Al or Brady or anyone. On

Wall Street, honesty doesn't raise an eyebrow, even when it involves over a million dollars. I guess it should surprise no one that dishonesty goes unnoticed as well. There really is no right and wrong on Wall Street, I thought to myself. Just money.

The Dupe: Jack's AT&T Upgrade

And because money never takes a vacation, there was no time to grab a sandwich with my new colleagues or figure out where the men's room was. The next Friday, the day after Thanksgiving, *The Wall Street Journal* printed an article saying that AT&T was considering selling a 10–15 percent stake in its wireless unit to the public.[5] It would be a $10 billion IPO. If true, it would be a juicy plum of a deal, the largest IPO in U.S. history, generating over $300 million in underwriting fees. The scuttlebutt was that AT&T would choose three banks to co-lead the deal, and each of the three could make something on the order of $65 million. It was a monster, all right.

I hadn't been over the Wall, so I read about it in the paper like everyone else. My first reaction was that, like the wireless and cable tracking stock I had championed a year earlier, it might lead to a higher AT&T stock price. I figured AT&T was hoping to profit from investors' seemingly insatiable appetite for new companies with high growth potential. Sure AT&T was still considered a stodgy stock at best, but its cellular business was very hot, and all signs pointed to a very successful IPO. I thought it was a good move, and it certainly would be good for my Buy rating on the company. In fact, the stock jumped 8 percent on the *Journal* story alone.

I thought CSFB had a very good shot at winning the third underwriting slot in the deal. Mike Armstrong, AT&T's CEO, had done much of his banking with Goldman since he'd been at DirecTV, and Merrill was probably a shoo-in thanks to Linda Runyon Mutschler's number-one wireless ranking in the *I.I.* magazine poll. But a banker at CSFB used to work with Dan Somers, AT&T's CFO, and apparently had a great relationship with him. And Cindy Motz, CSFB's wireless analyst, had risen very quickly to number three in the *I.I.* poll and might challenge Linda in another year or two. I figured AT&T would be impressed with that. I, of course, had been bullish on AT&T and, fortunately, its shares were up almost 11 percent after adjusting for stock splits since my upgrade about a year ago.

The other possible contender was Salomon Smith Barney, but in this case Jack Grubman actually hurt its chances. His Neutral rating and acerbic remarks about AT&T and Mike Armstrong had totally

alienated AT&T management. It didn't matter financially to me, of course, whether we won it or not, but I certainly hoped we would.

And then, on November 29, some news crossed the wire that made me sick. Jack had suddenly upgraded AT&T to a Strong Buy—this after dissing the stock for four straight years. There was no particularly great news that justified an upgrade, no major change in strategy, no nothing—except, of course, for a chance to get in on the biggest IPO of all time. I don't know why I even bothered feeling shock or surprise by this time—it was getting old—but I was aghast. Everyone knew how aggressively negative he'd been on the stock. He'd been extremely critical of the company's cable telephony strategy, seeing it as too expensive and too late, and likely to be a huge waste of money. But now, in his new report, he suddenly claimed that the strategy was going to work like a charm.

I wasn't the only one to react cynically to the news. Many clients forwarded Jack's report to me with snarky comments such as "Check this out. You're not gonna believe it" or "I smell a deal coming." The move seemed so patently obvious that surely it would never work. He had stooped to a new low, it seemed, in order to horn in on this gargantuan banking deal. Surely, the folks at AT&T would understand that too. They weren't stupid.

My reasoning was reinforced a week later when *The Journal* published a story in its "Heard on the Street" column by Randall Smith and Leslie Cauley titled, "Will Upgrade of AT&T Stock Help Salomon Smith Barney?"

"As AT&T gears up for another blockbuster IPO," it read, "…the betting on Wall Street is that one of the firms with a role in the underwriting will be…you guessed it—Salomon." The article continued: "People familiar with the matter say Sanford I. Weill, co-CEO of Salomon's parent, Citigroup, and an AT&T board member, nudged Mr. Grubman to give AT&T a fresh hearing. One person who knows AT&T says its chairman, C. Michael Armstrong, has regularly asked Mr. Weill to urge Mr. Grubman to revisit the merits of AT&T's cable strategy. 'Anyone who knows me knows that I call them as I see them,' Mr. Grubman said. 'No one tells me what to do.'"[6] If *The Wall Street Journal* was casting aspersions, I thought to myself, no company with any self-respect—certainly not conservative, image-conscious AT&T—could fall for such an obvious ploy.

In the meantime, I had a lot of work to do getting ready to launch coverage at CSFB. I didn't intend any dramatic ratings changes, but I

still had to write new reports and explain my reasoning on every stock I covered. My team and I were excited to be at a firm serving institutional clients only. In contrast to life at Merrill, we no longer needed to simplify our writing or presentations for consumption by thousands of retail investors. And we no longer had to worry that every word we wrote or spoke might be misunderstood. In a lot of ways, I felt as if I had been released from retail jail.

That's because CSFB had no retail brokers, other than some salespeople who served very high net worth individuals who were generally quite sophisticated businesspeople and corporate executives. CSFB's institutional sales force, about 150 strong throughout the world at the time, comprised MBAs and others with substantial experience in the markets. The only challenge was that I had to convert my recommendations to CSFB's unique rating scheme. While Merrill's scheme of intermediate versus long-term ratings and various risk and dividend ratings was confusing in its endless categories and criteria, CSFB's had terminology that didn't match up well with that used by the rest of the Street.

Though it was a multilevel system like Merrill's and each level (1, 2, 3, etc.) represented the same percentage upside or downside, CSFB's top rating, Strong Buy, was what Merrill called a Buy. Its second rating was Buy, which is what Merrill called Accumulate and Salomon Smith Barney called Outperform. Despite the confusing semantic differences, these rating systems were virtually identical. A "1" suggested the analyst felt very strongly that this stock was going to do very well, outperform the market by a substantial amount, and had upside over the next year of 20 percent or more. Similarly, regardless of whether it was called Accumulate, Outperform, or Buy, a "2" meant the analyst thought the stock would outperform the market by a small amount and had upside in the 10–20 percent range. But those who weren't clients often confused our Buy, or "2," rating with other firms' Buy, which for them was their top rating.

CSFB also had only four choices for ratings, where the others had five. In the case of a "4"-or "5"-rated stock, CSFB used Sell, but the rest of the Street had a quirky nomenclature, clearly intended to soften the blow to investment banking clients and, in some cases, to buy-siders who got angry when a big stock holding of theirs was slammed by an analyst. So, if an analyst thought there was 10–20 percent downside in a given stock over the next 12 months, the appropriate rating was Reduce at Merrill, Underperform at SSB, and Sell at CSFB. And if the analyst thought there was more than 20 percent downside over that same time period, the stock would be

rated “5” and labeled Avoid at Merrill, Sell at SSB, and, again, Sell at CSFB.

“I’ve Never Had a Conversation Like This.”

Toward the end of December, we made our formal pitch to AT&T in front of its treasurer and its new CFO, Chuck Noski. Chuck, another Hughes Electronics transplant, had just signed on that month. He was truly a wild card: he hadn’t been in the telecom industry. He didn’t know many of the telecom bankers nor did he know any of the twenty or so Wall Street analysts who followed AT&T. He certainly didn’t know much about Jack’s “special” approach to the analyst’s role, though I supposed he knew Jack could move stocks far more powerfully than the rest of us.

It was a bit of a problem for CSFB, since its bankers had had the closest relationship with Chuck Noski’s predecessor, Dan Somers, whom AT&T’s CEO, Mike Armstrong, had just sent out to Denver to run its cable business. We met with Chuck and his team two days before Christmas to display our wares, much as a traveling salesman would sell pots and pans. Only what we were essentially selling was the ability to sell.

Most of the pitch meetings I’ve ever been in have been the same, and this one was no different. The bankers proffered their services, and CSFB wireless analyst Cindy Motz and I talked about our research. AT&T executives asked us questions, such as how could they best reach retail investors if they went with CSFB, which didn’t have retail brokers or customers, what was the right price for the shares, and what aspects of the company should be emphasized during the road show. I thought the CSFB team handled the meeting well, and we waited expectantly for the news.

Sometime around the end of January, I got word from Chuck Ward, the head of CSFB’s investment bank, that made me realize—yet again—how naïve I still was. He called me up to his office, where he told me he had talked with Chuck Noski and that it looked as if AT&T had decided to go with three bankers. He said that one of them was going to be Salomon, which meant that not one of them was going to be us, since Goldman and Merrill were shoo-ins. We were screwed—and Jack had been rewarded for what seemed the most sinister move I’d seen in my 11 years as a research analyst. In addition to my own personal anger and frustration, I was embarrassed for AT&T, since everyone, and I mean everyone, saw right through this one.

Furious, I told Chuck that I was going to call Chuck Noski and tell him how outrageous I thought this was. He smirked and said, “Good luck. I guess we’ve got nothing to lose.” I don’t know whether I thought I could actually make a difference, but there was nothing that could stop me at that point. All I could think was that Jack’s model was now the only working model for an analyst. There had to be something I could do about it.

I had met Chuck Noski for the first time during the pitch meetings. Short in stature and quiet in demeanor, he seemed very smart and very analytical. I figured he could use an education in Grubman’s World, a world a lot like *Wayne’s World:* you had to live in it in order to believe it. I hoped I could show him how bad it would look for AT&T to pick Salomon. And if I could change his mind, I would also be showing Chuck Ward that I could make a difference for CSFB.

So I put in a call to Chuck Noski. He called back a day later, just as I was boarding a plane from Portland, Oregon, to Whistler, the Canadian resort where I was going to spend a few days skiing with clients after four grueling days of meetings up and down the West Coast. I had 10 minutes before the plane took off, so I didn’t waste any time once Chuck confirmed to me what I feared was true—that AT&T was getting ready to announce it had hired Goldman, Merrill, and Salomon as lead underwriters.

“Chuck, I want to apologize at the outset of this conversation,” I started. “My plane is taking off in less than 10 minutes and I need to quickly convey some things to you about my competitor at Salomon. I may not come across as politely or professionally as I normally would like to.”

“Go ahead, Dan, I’m a good listener,” Chuck replied.

“Grubman’s research is a sham,” I blurted, every bit of self-control I had evaporating. “He sells his Buy ratings for investment banking business. In effect, he’s a whore and everyone knows it. If you guys hire Salomon, you will be perceived as naïve dupes, and shareholders will lose respect for AT&T management.”

I tried to tell Chuck that by rewarding this behavior, he was simply encouraging more and more research analysts to emulate Jack’s approach, and that that wouldn’t benefit anyone. I was more emotional, and more personal, than I’d ever been with a company executive. He heard me out, but he was clearly taken aback, particularly by the fact that I would dare to call my competitor a

whore and him a dupe.

"I've never had a conversation like this, Dan," he said.

"This is really a different industry," I said. "Grubman's behavior is really outrageous."

Finally, Chuck told me that he'd discuss our conversation with Michael Armstrong.

"I have taken notes and I've heard you," he said politely but firmly.

Well, I guess he had heard me, but he certainly didn't listen to me. CSFB would end up being a co-manager with about six other firms, the booby prize after losing out on the world's biggest IPO ever. CSFB's take was $15 million instead of the $63 million that Salomon, Goldman, and Merrill each took home. Jack had delivered a $48 million bonus to his firm with a few strokes of the keyboard.

As I walked across the tarmac toward the waiting twin prop, I was truly disgusted—with Wall Street, with the analyst community for imitating people like Jack, with the press for celebrating him, and with corporate America in general for its willingness to deal with the devil.

The fact that Sandy Weill, the co-CEO of Citigroup, which owned SSB, sat on AT&T's board, while Armstrong sat on Citigroup's board, troubled me a lot too. Critics of these "interlocking directorships" considered them to be a corporate governance no-no because of the temptation for mutual backscratching, and suddenly I could see why. There was one other explanation for the move, although it was the most pathetic one: perhaps Mike Armstrong simply thought Jack's November upgrade was a great piece of honest research extolling the virtues of his cable telephony strategy. If so, Armstrong was the only one on earth who believed that Jack's upgrade was authentic.

That evening, I returned a call to Rebecca Blumenstein of *The Wall Street Journal,* who was preparing a story about the intense battle between SSB and CSFB for the third and last lead underwriting spot. She wanted to know what was going on and whether I knew if a final decision had been made. I played somewhat dumb—not so dumb as to make her think I wasn't a player but enough so that I could deny that I knew the final decision. In any case, she wrote a fairly accurate article that said CSFB had fought hard but lost, and that given my recent arrival at CSFB and the firm's historical excellent investment

banking relationship with AT&T, this was somewhat embarrassing for me.[7]

It *was* embarrassing for me, but it was even more embarrassing for my profession and for Mike Armstrong and Chuck Noski. I was also, I suppose, a bit embarrassed about my outburst. Chuck Ward later told me that he had called Dan Somers, AT&T's former CFO, to follow up, and that Dan had told him I had "made enemies of friends." Nice way to start off on the right foot with a new job, I thought ruefully. Chuck Ward never asked for my help again. I guess I had devised one very effective way to get bankers off an analyst's back.

A few years later, in November 2002, Chuck Noski announced his resignation from AT&T. We had maintained a decent professional relationship despite its awkward beginnings, so I called to congratulate him. After a bit of pleasant chitchat, his tone turned serious. He told me that he regretted not listening to me about the IPO. I'm sure he did; the whole thing unleashed a storm of controversy that would later envelop Jack, Sandy Weill, and Mike Armstrong, among others. But at the time, all we knew was that Jack's way was the winning way.

8. Humpty-Dumpty

2000

Without realizing it at the time, I presided over what was probably the last hurrah for the fearless leaders of telecom. My conference coincided perfectly with the absolute zenith of the bull market. There was a giddy hysteria to it that at the time was thrilling and contagious; looking back, it seems pathetic. Everyone there was making money hand over fist, from the executives whose stock options were soaring to the bankers who were awash in deal fees to the institutional investors who, armed with that extra edge, were getting to IPOs and M&A announcements just a little bit sooner than the rest of the world.

Playing with the Devil

THE NEW MILLENNIUM DAWNED with the kind of frenzied excess that had come to seem normal. In retrospect, it was really the dancing-on-graves-with-fingers-crossed kind of mania that happens when everyone knows in their heart that it just can't last. The first big telecom event of the year was Salomon Smith Barney's annual Palm Springs telecom and media conference in January, hosted by Jack Grubman. I wasn't invited, of course, but I paid a lot of attention to the wires, since some news was likely to break during the event.

Like my conference, it was a star-studded gathering, a who's who of telecom attended by many of the industry's top executives. Our two events, held just two months apart, were the two best-attended conferences for telecom investors, and we each tried to put on the most dynamic show possible. Jack's event, because it took place at a golf resort, was more casual in style, while ours, in New York, was a bit more formal and urbane. As always, we were competing—this time, to attract the most influential speakers and attendees, who would, hopefully, bring to light some important new information.

In Palm Springs, Bernie Ebbers and Scott Sullivan of WorldCom were the most popular speakers, and rightfully so, since the company's

stock continued to soar, having nearly quintupled in the previous four years and become the NASDAQ's most successful stock of the decade. The gym teacher cowboy from Canada and the numbers whiz from upstate New York were the dream team of telecom who had transformed the industry like no others. Way back in 1995, the company had hired Michael Jordan as a spokesperson. And now, it seemed, WorldCom had become the Michael Jordan of its own sector, outhustling, outthinking, and out–wheeling and dealing its plodding competitors. (In 2005, Michael Jordan would sue the company, claiming that the company owed him $8 million.[1])

But what Bernie and Scott were saying on this day, though diffused in a fluffy cloud of optimism, got some tongues wagging. Clients called to tell me that one of their slides showed a revenue growth range of 13.5–15.5 percent for the year 2000. It was a terrific range to have, but it wasn't quite the 14.5–15.5 percent range that had been cited in their conference call a few months earlier, in October.

A full percentage point may not seem like a lot, but it can have a major effect on investor perceptions and, if the downward trend continues, on a company's stock price. Conference attendees buzzed. Were Bernie and Scott saying that the real number was only 13.5 percent now and the Wall Street consensus of 14.5–15.5 percent was too high? Were they just hedging in case the economy slowed? Or did they know something we didn't? Some of the biggest WorldCom bulls actually wondered whether the presentation simply had a typo. People asked Scott what it all meant, but he simply said that that was the range, and not to read any more into the top end of the range than the low end. That day, WorldCom shares fell 11 percent, from $49.94 to $44.44. It sure looked as if the attendees at Salomon's conference were reading more into the low end.

The stock settled down after a few days, but toward the end of January it began to slide again, falling about 25 cents a day or so. I watched with concern, as I still had a Strong Buy, or "1," rating on it, the top rating in CSFB's system, and finally called some of my clients to see if they knew anything. One of them told me that he'd spoken to Jack, who had said he'd talked to Scott and that 13–15 percent, not 13.5–15.5 percent, was actually more accurate, with the lower end more likely than the higher end.

We all knew better than to believe everything Jack said by now, but when it came to WorldCom, it was foolish to ignore him: he was better connected with this company than anyone, and he'd certainly

come up with critical information before. If this information was true, however, it was a terrifying number for anyone who owned WorldCom, since if the revenue numbers came out that low, the stock would surely plummet.

This was particularly true for a growth company like WorldCom with a suddenly slowing growth rate. Wall Street is a game of expectations: when expectations are not met, the market usually reacts swiftly and brutally. I was worried, but I didn't want to change anything until I had more than hearsay backing me up.

At the end of January 2000, I hosted a luncheon for Ivan Seidenberg, CEO of Bell Atlantic, and invited some money managers from the country's biggest financial institutions. This was one of those perks for the most favored—or most powerful—clients; an intimate group of 20 people lunching with a top executive. I held about eight of these each year, and almost always scheduled them in the elegant Library Room on the second floor of the St. Regis Hotel. The St. Regis, located in midtown Manhattan, was one of New York's swankiest hotels, a place where the ornate Louis XIV–decorated rooms went for around $575 a night.

As my handpicked group of powerful investors chatted before sitting down, I heard more about Jack's claim that he'd talked to Scott Sullivan. The irony was that Jack was now so powerful that these rumors took on a life of their own. He had succeeded in making everyone believe that his relationship with WorldCom was so tight that even if what he said wasn't true, few would doubt him. Anything he said was now as important, if not more important, than what Bernie or Scott said about WorldCom. I had no idea what was correct; all I knew was that the stock was dropping.

After lunch I asked Ehud Gelblum and Ido Cohen, an extremely bright young analyst I had hired shortly after my move to CSFB, to call Blair Bingham, one of WorldCom's investor relations guys, and press him for some more information. I showed Ivan out and returned to the St. Regis's Library Room to hear Blair, on speakerphone, reiterating that the range remained 13.5–15.5 percent.

I jumped in. "Hi, Blair, this is Dan," I said. "Here's our dilemma. We're recommending your stock with a Strong Buy rating. We're getting a lot of questions lately, because apparently Jack is saying that the revenue forecast should be closer to the lower end of that range, based on a recent conversation he had with Scott."

Blair dismissed my question right away. “I don’t know anything about such a conversation, Dan,” he said, “and I don’t know what Jack is saying, but it doesn’t matter anyway. Bernie told everyone in Palm Springs that the range was 13.5–15.5 percent and one shouldn’t read anything more into the lower end than the higher end.”

“I hear you,” I interrupted, “but you’ve got a problem. I don’t know who said what to whom, but I do know you guys have given Jack a very disproportionate voice on your stock. If he says revenues will grow 13 percent and you deny it, the vast majority of investors are going to either believe the 13 percent or live in fear of it. No one is going to believe you.”

I asked him to get Scott Sullivan, the CFO, on the phone. “Otherwise,” I threatened, “I’m going to have to cut our revenue forecast this afternoon.” I was playing hardball, but I needed some answers here.

“Well, uh, I’ll try,” Blair said doubtfully, “but I don’t know if I can find him…”

“We’ll just wait here on the line, Blair,” I said. “Thanks.”

Amazingly, Scott came on the line within five minutes.

“Hey, Dan, what’s up?” Scott began nonchalantly. No matter what was going on, Scott was exactly the same. He spoke in a monotone, dressed and acted conservatively, and never appeared to get excited when the stock was soaring or distressed when it wasn’t. He was as steady as Qwest’s Joe Nacchio was volatile.

“Just trying to get a read on your outlook for revenues and struggling with Jack’s banter that it’s going to be lower than you’ve indicated,” I said.

“What do you mean?” asked Scott.

“Come on, Scott,” I said. “You know how this works. You, or perhaps Bernie, told the Salomon conference that you were anticipating revenues to grow 13.5–15.5 percent this year. But then I’m hearing from some buy-siders that Jack cited a private conversation with you in which you endorsed the lower end of a 13–15 percent range.”

Scott denied it. “I haven’t talked to him since his conference,” he said.

“If you haven’t talked to him,” I said, “then you need to say that publicly. Right now, your largest holders are believing him, as he has quite a record of having far better information than the rest of us,” I continued, and then added for effect, “Even those of us who have been bullish on your stock.”

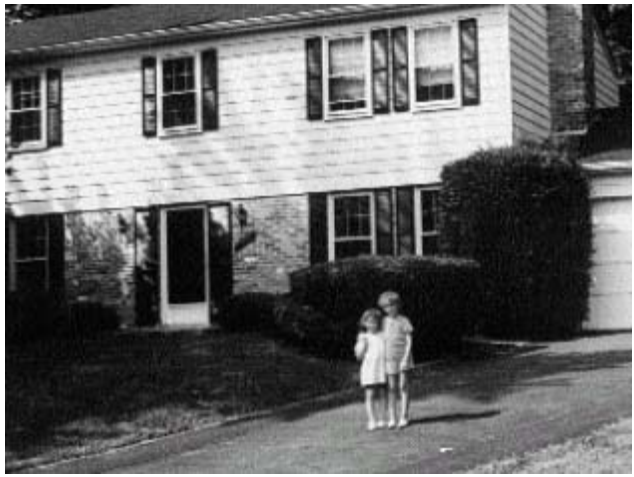
“I’m telling you now,” Scott said, exasperated. “Why don’t you pass this on to your clients?”

“It won’t do much good, Scott. You have created your own monster here,” I said, referring to Jack.

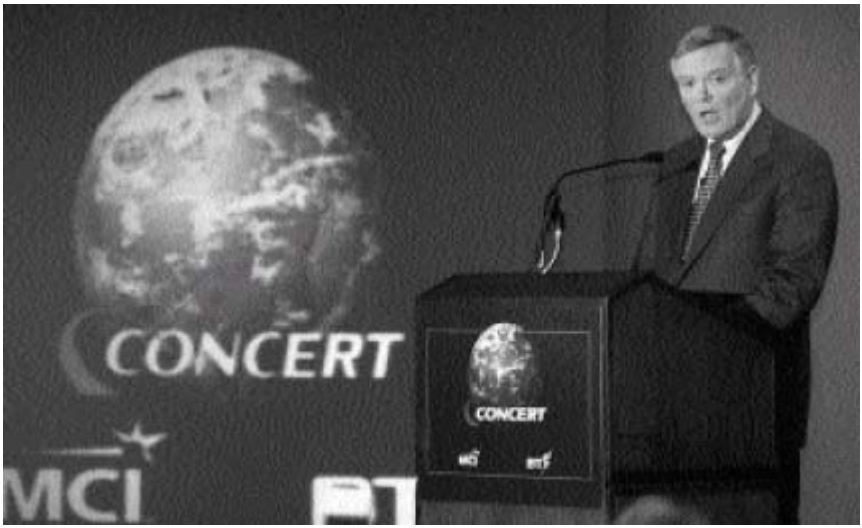
Scott denied it again.

Photographic Insert

Author as college student studying Middle East politics: Here shown touring ruins of Troy (Ephesus, Turkey), Summer 1973.



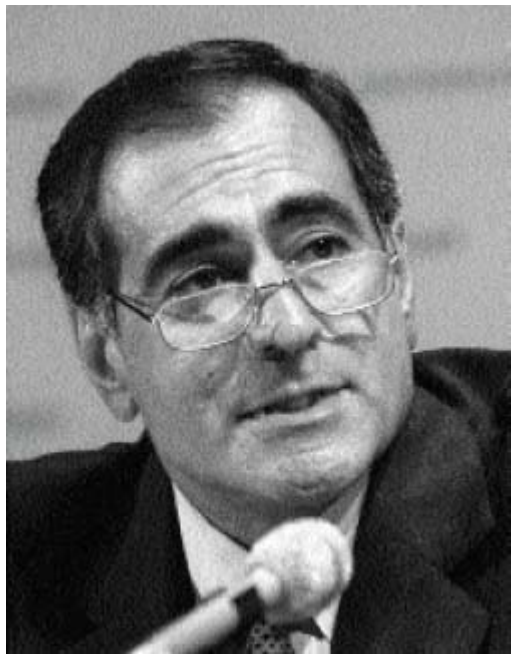
Our home and daughters in Potomac, MD, 1988: “Ed took one look at the house and almost started laughing. ‘You ought to come to Wall Street and hit the big time,’ he said.”



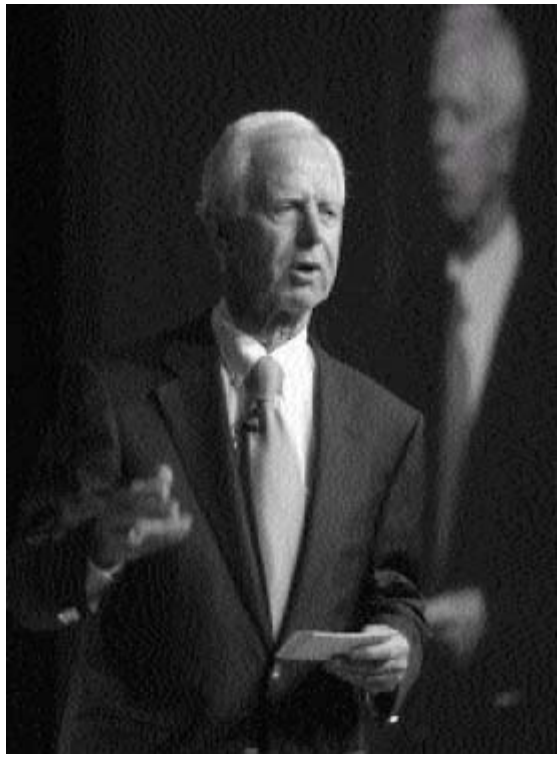
Bert C. Roberts, Chairman and CEO of MCI Communications announcing MCI's merger with British Telecom, the largest cross-border merger ever at the time. The deal fell apart but Bernie Ebbers of WorldCom stepped in, taking over MCI and sealing Bert's and MCI's fate November 3, 1986. (*AP/Wide World Photos)*

Author (right) and Ed Greenberg, Morgan Stanley's telecom analyst, with chauffeur and Bentley hired by Morgan Stanley to shuttle us between meetings with European investors. November 1988. Six months later, Ed convinced me to take over his job at Morgan Stanley. *(Jim Hayter)*

Author (left), Dan Akerson, MCI's CFO (middle), and Jim Hayter, MCI's Director of Investor Relations, in Zurich, Switzerland, taking a break between meetings with Swiss institutional investors. November 1988. *(Jim Hayter)*



John Mack, President of Morgan Stanley, CEO of CSFB and now CEO of Morgan Stanley. “Sure John,” I said. “How can I say no to an invitation from John Mack?” *(AP/Wide World Photos)*



Arthur Levitt, SEC Chairman 1993-2001. Levitt may have made speeches about analyst conflicts of interest but, on his watch, the SEC issued the "No Action Letter" that propelled analyst conflicts to new heights. *(AP/Wide World Photos)*

The Siskel and Ebert of

Opposite Reviews On the Baby Bells

By MARK LANDLER

JACK GRUBMAN and Dan Reingold say they like each other. You'd never know it from the hand grenades they toss back and forth.

In a new report, Mr. Grubman, a prominent telecommunications analyst at Salomon Brothers, said any analyst who would recommend the stocks of regional Bell telephone companies was "slurry eyed," "bull headed" and "nuts." Mr. Grubman acknowledged that this was a reference to Mr. Reingold, his equally prominent counterpart at Merrill Lynch & Company.

DAN REINGOLD, 42. First vice president, Merrill Lynch

- WALL ST. CAREER – Joined Morgan Stanley in 1968; joined Merrill Lynch in 1980
- BACKGROUND – Corporate planner and budgeter at MCI for six years
- GOOD CALL – Predicted passage of telecommunications bill and its implications
- BAD CALL – Downgraded MCI when it was trading at $18; it is now at $28

"The Siskel & Ebert of Telecom Investing." The *New York Times* Sunday Money & Business section featured a front page article contrasting Jack Grubman's and my styles and opinions. February 4, 1996.*(New York Times)*

Telecom Investing

For his part, Mr. Reingold said Mr. Grubman was "intuitive and gut-oriented." Explaining how he differs from that approach, he said, "Before making conclusions, I try to do the work."

Such verbal fisticuffs would not be remarkable in the rough-and-tumble world of stock picking, except that Mr. Reingold and Mr. Grubman are the Siskel and Ebert of telecommunications analysts. Mr. Reingold is ranked first, and Mr. Grubman second, in the annual ranking of telecommunications analysts by Institutional Investor magazine. Both also began their careers in the industry they now track — Mr. Grubman at AT&T and Mr. Reingold at MCI.

For all their similarities, the two men now have diametrically opposed views of the industry. The gap between them underscores just how murky the outlook for telecommunications has become as it faces deregulation and unprecedented competition. It also smacks of an old-fashioned epic battle between two highly paid, closely followed industry stars.

"These are two of the most competitive people I have ever met," said Peter Coutroubis, the executive director of investor relations for the Bell Atlantic Corporation. "They are both intensely driven by recognition and success."

As fun as it is to watch, the rivalry raises a sober question: Where should investors listen to as they place bets on a vital industry in the grip of dizzying change? AT&T, GTE and the seven Baby Bells are among the 10 most widely held issues on the New York Stock Exchange.

Mr. Reingold contends that the Bells will be the big winners from the telecommunications bill, which Congress passed on Thursday, because the legislation would free the companies to compete in the $70 billion long-distance telephone market. Mr. Grubman says that even after President Clinton signs the bill into law, the Bells stand to gain precious little.

Mr. Reingold is recommending that investors buy the shares of the seven Baby Bells; Mr. Grubman is steering his clients away.

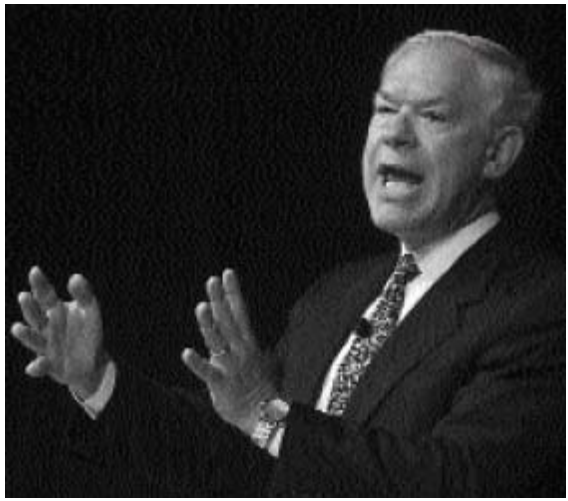
"You have two guys who have looked at the same issue, and one guy sees it this way,

Continued on Page 8

JACK GRUBMAN, 48, Managing director, Salomon Brothers

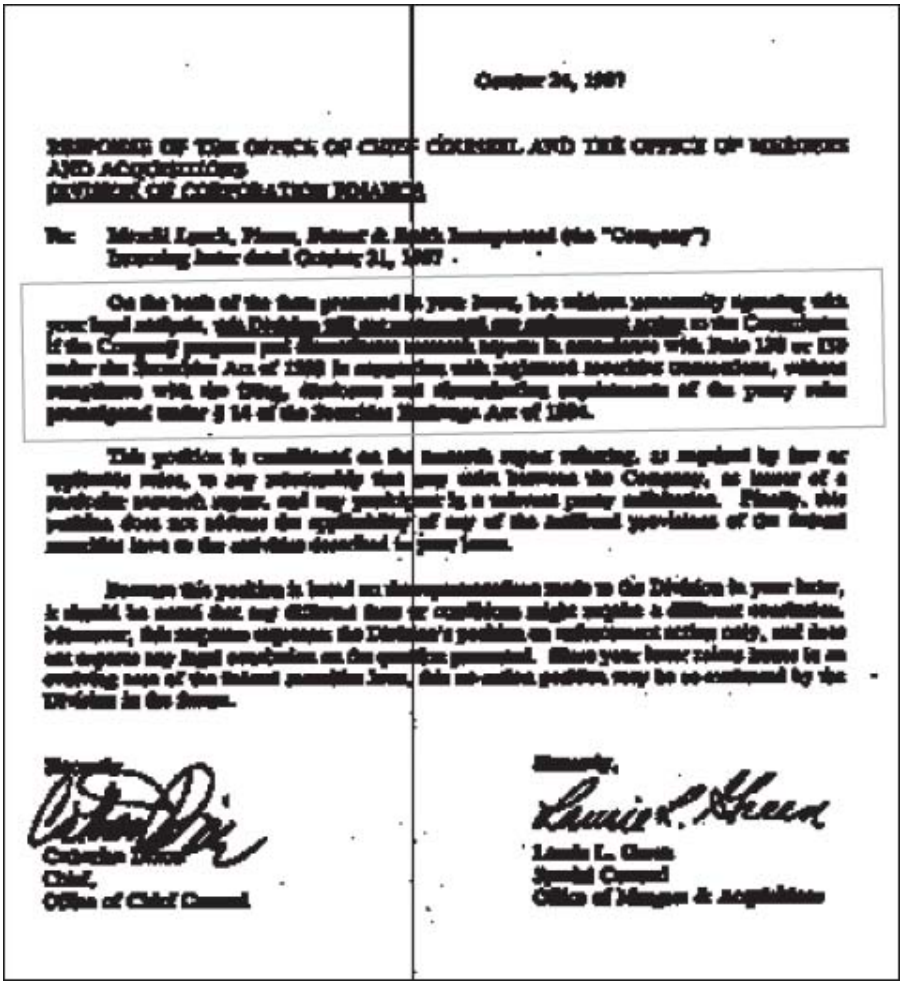
- [illegible] – Joined Paine Webber in 1985; joined Salomon in 1994.
- [illegible] – Was at AT&T for eight years, three in the regulatory department.
- [illegible] – Picked Telefonos de Mexico in 1993; the shares rose 30 points.
- [illegible] – Downgraded AT&T just before it made moves that lifted its stock.

“Jack Grubman and Dan Reingold say they like each other. You’d never know it from the hand grenades they toss back and forth.” *(*Mark Landler, *New York Times)*



Evangelist for the Internet: Jim Crowe, CEO, Level 3 and (previously) CEO, Metropolitan Fiber Systems (MFS). Jim tried to turn me into an Internet believer but I just didn't "get it." *(AP/Wide World Photos)*

A savior's arrival? Mike Armstrong is welcomed by Bob Allen, AT&T's outgoing Chairman and CEO. October 20, 1997.*(AP/Wide World Photos)*



October 24, 1997

RESPONSE OF THE OFFICE OF CHIEF COUNSEL AND THE OFFICE OF MERGERS AND ACQUISITIONS
DIVISION OF CORPORATION FINANCE

Re: Merrill Lynch, Pierce, Fenner & Smith Incorporated (the "Company")
Incoming letter dated October 21, 1997

On the basis of the facts presented in your letter, but without necessarily agreeing with your legal analysis, the Division will not recommend any enforcement action to the Commission if the Company omits such shareholder proposals from its proxy materials in reliance on Rule 14a-8(i)(7) under the Securities Act of 1934 in connection with stipulated executive transactions, without compliance with the filing, disclosure and shareholder requirements of the proxy rules promulgated under § 14 of the Securities Exchange Act of 1934.

This position is conditioned on the proposals being withdrawn, as required by law or applicable rules, by any proponent that may exist between the Company, as issuer of a particular proposal, and any proponent in a relevant proxy solicitation. Finally, this position does not address the applicability of any of the additional provisions of the federal securities laws to the activities described in your letter.

Because this position is based on the representations made to the Division in your letter, it should be noted that any different facts or conditions might require a different conclusion. Moreover, this response expresses the Division's position on enforcement action only, and does not express any legal conclusion on the question presented. Since your letter raises issues in an evolving area of the federal securities laws, this no-action position may be reconsidered by the Division in the future.

Sincerely,

Christina Dixon
Chief,
Office of Chief Counsel

Sincerely,

Laurie L. Green
Special Counsel
Office of Mergers & Acquisitions

The SEC's "No Action Letter" that propelled analyst conflicts to new heights. October 24, 1997.

SBC CEO Ed Whitacre and Ameritech CEO Dick Notebaert announcing the sale of Ameritech to SBC for $62 billion. My firm, Merrill, tried desperately for a role but failed and so did I. May 11, 1998. *(AP/Wide World Photos)*

Mike Armstrong, CEO of AT&T, and John Malone, CEO of Tele-Communications Inc., taking questions after announcing AT&T's $32 billion acquisition of Malone's cable TV company. Armstrong had dreams of bundling phone, internet, and entertainment services over cable TV lines. June 24, 1998.*(AP/Wide World Photos)*

Like blood brothers, Qwest CEO Joe Nacchio and US West CEO Sol Trujillo yuk it up at the press conference announcing the merger of their two companies. Two days earlier, Nacchio threatened to back out of any deal that required him to share the CEO role with Trujillo. July 19, 1999. *(AP/Wide World Photos)*

One amazing leak: On October 5, 1999, Sprint CEO Bill Esrey (left) and WorldCom's Bernie Ebbers announced the merger of their two companies. But 27 days earlier, the deal and its exact price had been leaked. The stocks' values changed by a total of $14 billion during that period.*(AP/Wide World Photos)*

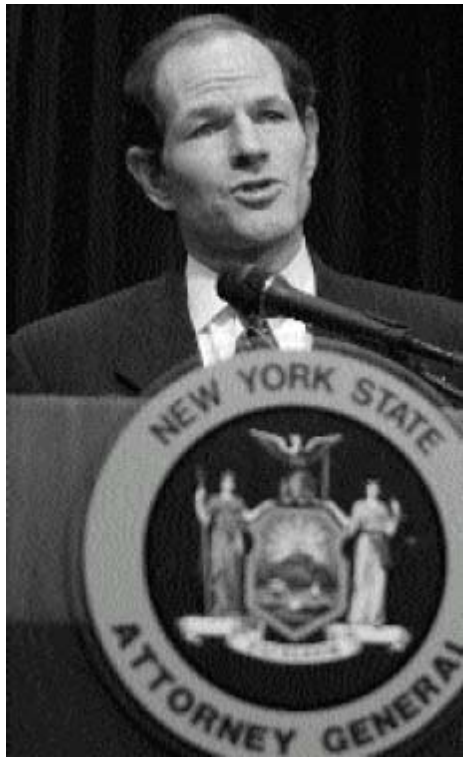
Merrill Lynch CEO David Komansky was President and then CEO during my nearly seven years at Merrill. June 1,1999. *(AP/Wide World Photos)*

Joe Nacchio, CEO of Qwest, talking up his company and the Internet. Qwest would later admit to inflating its revenues by $3 billion. *(AP/ Wide World Photos)*

AT&T Wireless IPO: CSFB (my firm) and Salomon Smith Barney (Grubman's firm) competed hard for a lead role in the $10 billion AT&T Wireless IPO, the largest in US history. AT&T CEO Mike Armstrong (left), AT&T Wireless CEO John Zeglis (middle), and New York Stock Exchange Chairman Dick Grasso, celebrating the initiation of NYSE trading. April 27, 2000. *(AP/Wide World Photos)*

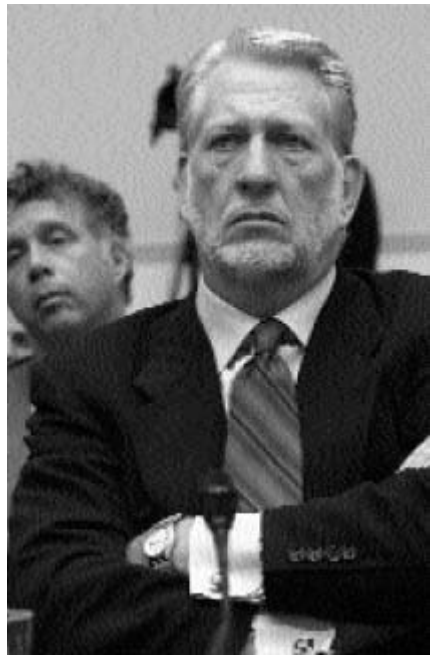
My arb call from a mountaintop: waiting to speak on Qwest/Deutsche Telekom/US West rumors via CSFB's squawk box from Vail, Colorado. The rumors created panic trading and huge opportunities. March 2, 2000. *(Howard Jacobs)*

Members of my research team on a ski outing with clients at Telluride, Colorado. (From left) Julia Belladonna, Bill Newbury of TIAA-CREF, Ehud Gelblum, author, and Ido Cohen. January 2001. *(Jeff Jacobs)*



Eliot Spitzer, New York State Attorney General, announcing his investigation into conflicts of interest in Wall Street research. Spitzer settled most cases, leaving many questions unanswered and misdeeds unpunished. April 8, 2002.*(AP/Wide World Photos)*

Congressional hearings on WorldCom: On July 8, 2002, just two weeks after the fraud was discovered, the House Financial Services Committee interrogated four key witnesses. (From left) Melvin Dick, Arthur Andersen; Bernie Ebbers, former WorldCom CEO; Scott Sullivan, former CFO; and Jack Grubman, Salomon Smith Barney telecom analyst. *(AP/Wide World Photos)*



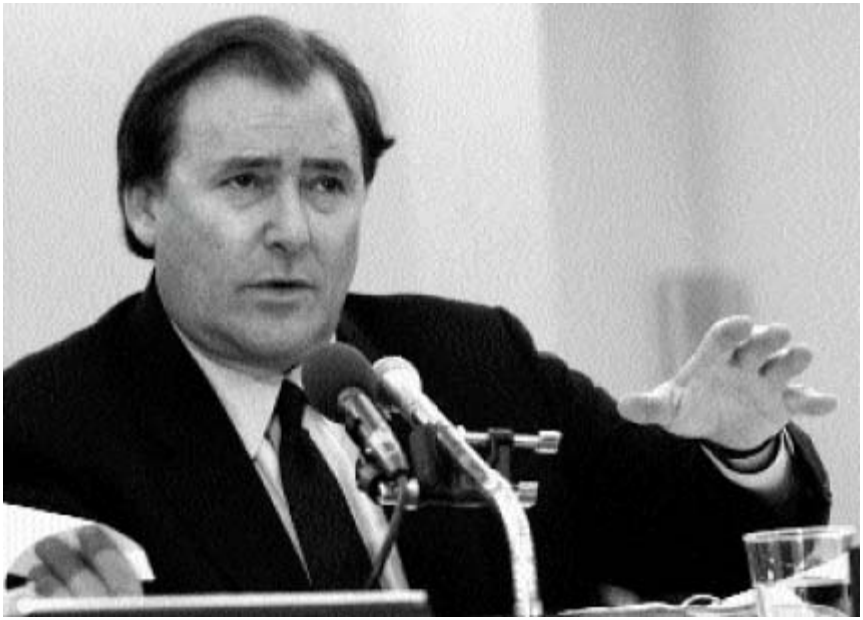
Ebbers, silent but stoic at the Congressional hearings, with his high-powered defense attorney, Reid Weingarten (left). July 8, 2002. *(AP/ Wide World Photos)*

Jack Grubman in front of the House Financial Services Committee: Asked whether he knew about special IPO allocations made to various telecom executives, Grubman waffled “I’m not saying no, I’m not saying yes. I just can’t recall.” July 8, 2002. *(AP/Wide World Photos)*

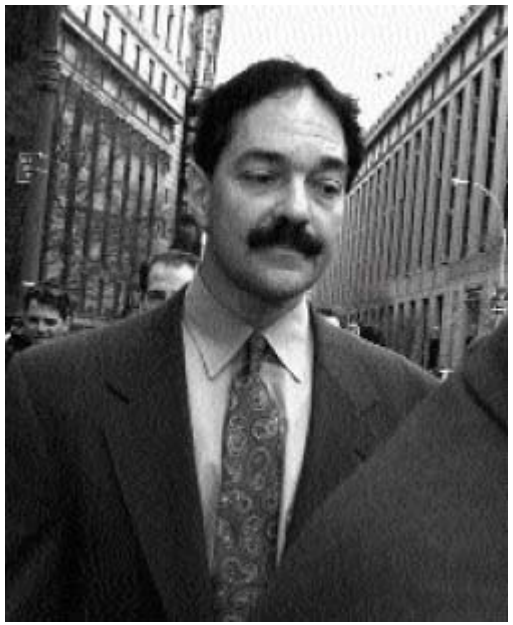
Scott Sullivan, former WorldCom CFO, in front of the House Financial Services Committee. July 8, 2002. Sullivan's fraudulent adjustments to WorldCom's books totaled a mind-boggling $11 billion. He pleaded guilty to numerous criminal charges yet was a highly effective witness against Ebbers.*(AP/Wide World Photos)*

Handcuffed Scott Sullivan (left) is led by federal agents from the posh New York City Hotel Elysée at 7 a.m. on the morning of August 1, 2002. He was charged with seven counts of securities fraud, conspiracy and filing false statements and was later sentenced to five years in federal prison. *(AP/Wide World Photos)*

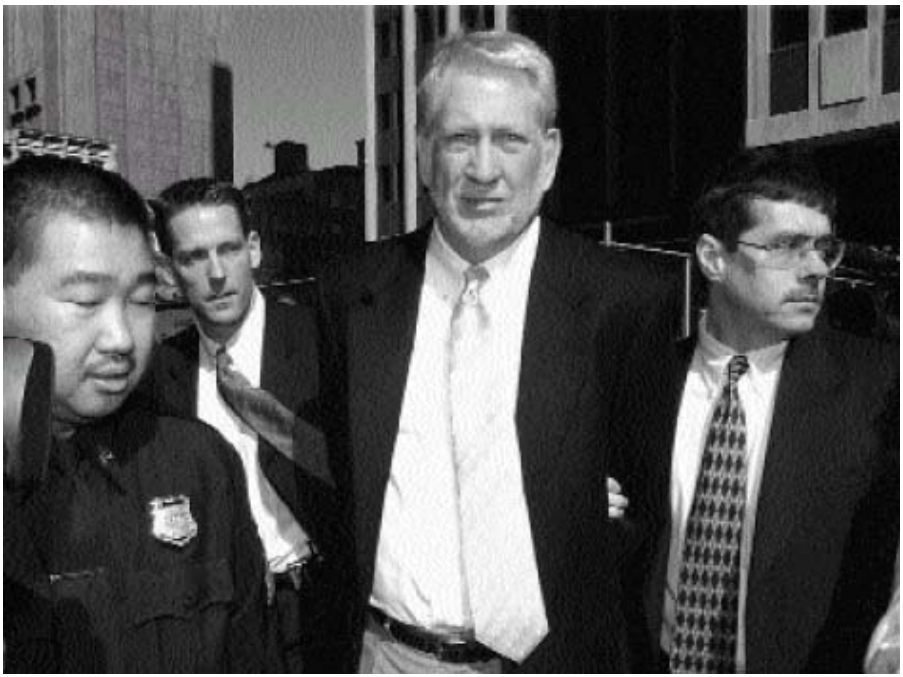
Global Crossing executives take oath before testifying before the House Energy and Commerce Subcommittee: (from right) Chairman Gary Winnick, CFO Dan Cohrs, Executive Vice President of Finance Joe Perrone, President David Walsh, and former counsel Jim Gorton. October 1, 2002.*(AP/Wide World Photos)*



Global Crossing Chairman Gary Winnick offered $25 million of his own money to cover losses in his employees' 401(k) accounts, a pittance compared to their losses and his gains. October 1, 2002.*(AP/ Wide World Photos)*



Frank Quattrone, technology banker extraordinaire, exiting Manhattan federal court. April 23, 2003. A jury found him guilty of obstruction of justice and he was sentenced to 18 months in prison. He is appealing. *(AP/Wide World Photos)*



Bernie Ebbers, handcuffed and escorted by federal agents, after being charged with securities fraud, conspiracy to commit securities fraud, and making false statements to the Securities and Exchange Commission. March 3, 2004. *(AP/Wide World Photos)*

Bernie Ebbers and his tearful wife, Kristie, leaving federal court after a jury found him guilty on all nine counts. He was later sentenced to 25 years in federal prison. *(New York Post/RexUSA)*

"Let's be real," I interjected. "The only way to avoid this in the future is to stop giving him special information as it just enhances his market power. Right now that's working against you and I'm powerless to help."

"Dan," Scott insisted, "I assure you that stuff is not going on anymore." Not going on *anymore?*

Well, if I'd ever needed any justification for all those sleepless nights, I now had it. It seemed Scott was admitting what I'd suspected for a long time: Jack was getting better information than the rest of us. In one sense, I felt vindicated. The conversation confirmed all of my worst suspicions about the Jack-WorldCom relationship.

On the other hand, I also felt sick. The way this business worked was beginning to disgust me. No matter how much analysis the rest of us did and no matter how much we knew about the telecom industry, we'd always know less about WorldCom than Jack Grubman. He not only knew more than the rest of us, but sometimes seemed to know more than the company itself.

"That's good," I said sarcastically, and Scott said he had to take another call. We signed off.

"What's the matter with these guys?" Ido asked. "Why would they voluntarily play with the devil?"

"Get it right, Ido," I said. "It's the devil playing with the devil. I guess that's why they get along so well."

I hate what this job has become, I thought. Everything is rumor, leaks, and guidance. Is anyone doing primary research anymore? Am I? Not really. I'm too busy keeping up with all these whispers and denials, because that's what moves stocks. I was spending most of my time trying to track down who said what to whom when I should have been out there talking to competitors, customers, and suppliers, kicking the tires of companies and figuring out what was really going on. This job was now less about analysis and more than ever about whom you knew. I was embarrassed, both for how my own work had become increasingly superficial and for the investment research profession overall. I wondered if I could make it through another three years.

A few weeks later, in early March 2000, the mouth of my dear old "friend" Joe Nacchio got him in trouble again—and forced me into another one of those seat-of-the-pants decisions that I hated so much. I didn't know it then, but it would turn out to be one of the last good calls of my career.

I was skiing at Vail's new-terrain, just-opened Blue Sky Basin with Jeff Jacobs, my friend and stockbroker from Merrill, and his father, Howard. It was a warm, sunny day, and we had just finished an unbelievable run through deep powder and were on the chairlift when my cell phone rang. I wanted to ignore it and get back to enjoying the Colorado sun and powder, but finally I pulled the phone from my jacket and saw that it was Julia Belladonna, one of my young team members who had come over with me from Merrill and worked with me on the Baby Bells.

"Hi," I said. "Just don't tell me Bernie's canceling [his commitment to give the keynote at my conference next week]." Julia, a serious, unflappable sort who had worked as a paralegal before deciding she wanted to break into equity research, was normally very calm, but there was a real edge to her voice. The cell signal was weak and it was hard to hear her, so I asked her to speak louder. Yelling, her words came through this time. "US West is getting hammered, Dan. All hell is breaking loose. The salespeople want you and want you now!"

"Oh, great," I responded. "What's going on?"

"There is some story flying around the Street," she said, "saying Qwest has been approached by a foreign company and Qwest may break off its deal to acquire US West."

The previous July, at the end of the bidding war between Global Crossing and Qwest for Frontier and US West, Qwest had agreed to buy US West, but the deal hadn't yet been finalized. The speculation apparently stemmed from a *USA Today* story that morning, March 1, 2000, citing people close to both Deutsche Telekom and Qwest confirming that the two telecom giants were in negotiations.[2] No one knew for sure whether this meant that US West would be included in such a deal or not. Yet the rumor seemed to be that Qwest would abandon US West at the altar, preferring to sell itself to Deutsche Telekom for a big profit.

If one looked at it from Qwest CEO Joe Nacchio's perspective, this

made tremendous sense: Joe would receive over $700 million in stock if Qwest were bought out by another company like Deutsche Telekom. All of his shares and options would vest immediately. Buy-siders later told me that Joe was fueling the fire by critizing US West's management at the same time that he was supposedly in negotiations with Deutsche Telekom.

Just as had happened two years earlier with the BT-MCI deal, I didn't know whether Qwest could, under the terms of its merger contract with US West, actually back out of the deal. As good as Vail's sunlight and visibility were from a skier's perspective, they didn't help me as an analyst. I simply couldn't be sure from the top of a mountain. In the meantime, US West shares were down big time, falling 11 percent that morning as the story spread, while Qwest shares had surged 26.5 percent on the takeover speculation.

This meant that US West was now trading about 40 percent below what Qwest had committed to pay in the deal, reflecting the market's fear that the US West–Qwest merger was dead in the water. People who owned US West were bailing out as rapidly as they could, while investors were piling into Qwest, thinking a rich price was coming soon from Deutsche Telekom. Much of this was fueled by arbitrageurs. Arbitrageurs, or "arbs," are the traders who make a living by betting on whether a given deal will happen or not and trying to take advantage of the difference between the original price offered for a company at the time a deal is announced and where it's currently trading, also called the "arb spread."

Usually, arb spreads run between 5 percent and 15 percent on mergers with six months or less to go until the deal closes. This time, the spread was huge, partly because of the uncertainty of the situation, but also because three years earlier, the arb community had lost so much money in the BT-MCI debacle that it had turned gun-shy on large telecom mergers. As a result, arbs were desperately unloading their US West shares, panicked that they would get burned as badly as they had been by MCI.

With all of this information swirling around the Street, I had to make a call quickly. My new sales force at CSFB, which had not yet seen me handle a crisis, and my clients were clamoring for instant advice, which meant I didn't have time to read the merger agreement or to call Joe Nacchio and Sol Trujillo or a few M&A lawyers to get some perspective, as I normally would. I asked Julia to call me back in 15 minutes, which would be 2:00 PM New York time and noon in Vail, and to arrange for me to speak into CSFB's "squawk box," which

would broadcast my comments to CSFB's salespeople around the world. This was the quickest way to get my views out to my clients, not to mention the best way to get my phone to stop ringing so I could get back to skiing. The last thing I wanted was to have another vacation ruined by a merger falling apart, especially on this beautiful mountain on this beautiful March day.

I hung up and got off the lift, almost dropping my phone in the snow. I quickly told Jeff and Howard what was going on. I asked them if they wanted to go on without me, but Jeff—always the stock junkie—said he wanted to hear what I had to say. Thinking frantically, I decided that if Deutsche Telekom did buy Qwest, it would be foolish to buy it without US West, both to avoid years of litigation and to get US West's local telephone assets—its "last mile" connections to customers—which I considered so valuable. I didn't have any facts or experts to back up what was essentially a gut feeling, and I wasn't going to acquire any in the next 15 minutes.

So just as I had done that night in Tuscany, I made a snap judgment, a potentially reckless one, this time from a Colorado mountain. We skied down until I spotted a small ridge in the sunlight. I looked at my phone to check the cell signal and it was strong enough. I sat down in the snow and called Julia, who connected me to CSFB's squawk box.

I explained my belief that the Qwest–US West merger would be very tough to undo, and discussed the widening arb spread. "My call is to buy US West and short Qwest shares, and it's based on my belief that US West is *not* going to be left at the altar. If the deal goes through in the next three or four months, as I continue to predict, you will make the arb spread, a return of approximately 40 percent."

When I said "short" Qwest shares, I was referring to the practice, used especially by arbitrageurs and hedge funds, of borrowing someone else's stock and selling it with the commitment to buy it back later. The shortseller's bet is that the stock's price will fall and he can then buy back the shares at a lower price, pocketing the difference. I thought that either the merger of US West and Qwest would go through as planned or Deutsche Telekom would buy both US West and Qwest. In either case, US West would be bought out and the huge spread between US West's deflated current price and the price Qwest was committed to paying would disappear, creating a huge profit for these investors.

It was not an easy situation to predict, especially given Nacchio's

tendency to shoot his mouth off, which is why I used the word "if." But it seemed obvious that the market was acting irrationally and panicking. It was one of those rare moments of opportunity you hope for as an analyst.

Who Wants to Be a Millionaire?

The gossip and innuendo related to Deutsche Telekom, Qwest, and US West continued to build over the next few days, providing the perfect dramatic backdrop to my conference, which we renamed the CSFB Global Telecom CEO Conference. It was to be held in New York City at the Plaza between March 7 and 10, 2000. Without realizing it at the time, I presided over what was probably the last hurrah for the fearless leaders of telecom. My conference coincided perfectly with the absolute zenith of the bull market. There was a giddy hysteria to it that at the time was thrilling and contagious; looking back, it seems pathetic. Everyone there was making money hand over fist, from the executives whose stock options were soaring to the bankers who were awash in deal fees to the institutional investors who, armed with that extra edge, were getting to IPOs and M&A announcements just a little bit sooner than the rest of the world.

Our budget for the conference was an astounding $1.7 million, not as much as my investment banking colleague Frank Quattrone's, but still a huge 70 percent more than what Merrill had allocated. And although I was still embarrassed by ostentation, I made sure the conference had all the trappings that executives and investors expected. I worked with a conference planner to choose entertainment, considering a lot of big-name performers, but ultimately chose the less showy comedian Darrell Hammond, the *Saturday Night Live* comedian most famous for his Bill Clinton impersonations.

Unfortunately, Hammond bombed. He made a lot of jokes about undeserving rich people that didn't go over too well in this crowd. We also set up something called a "Telecom Café," which had tons of Bloomberg machines for instant quotes and research, and flat-screen TVs so people could watch financial news shows. CNBC set up its own studio on the premises where its correspondents could interview our speakers. In the obligatory goody bag given to attendees, we provided everyone with a free MP3 player called the Rio. At the time, long before the iPod, this was one very cool gift.

From the moment the conference began that Tuesday, the town

cars were lined up three deep outside the hotel, with over 1,500 institutional and corporate attendees jostling for a position in the Plaza's Grand Ballroom to hear some of the 81 CEOs we had on the agenda. The venue was so crowded that it was physically difficult to get from one presentation to another, since the narrow hallways were clogged with frantic networking, card exchanges, and salesmanship. The CEOs were schmoozing the big money managers and either shopping for acquisition targets or trying to sell their own companies. CSFB bankers were trying to grease the wheels and earn some fees. And the investors were trying to find the next WorldCom, or at least hear what the old one had to say. Indeed, it was WorldCom's Bernie Ebbers who would kick off the conference with a dinner speech. He had also agreed to do a small private meeting that afternoon at 4:30 PM with some of the largest institutional investors.

At about 3:00 PM, I took a final walk through the ballroom and the smaller meeting rooms to make sure everything was in order. The rooms looked great, and I wanted to relax for a few minutes before showtime, so I headed down the hall toward the elevator to go to my room and just happened to catch a glimpse of Bernie down at the end of a very long corridor. He was sitting at a table, but it looked as if he was just staring into space. He was completely alone—no handlers, no investor relations guys, no buy-siders, no bodyguards (he was worth nearly a billion dollars at this point). It was bizarre. I couldn't remember ever seeing a CEO of a major corporation sitting by himself in a public place without someone to prep him or feed him or protect him or do whatever else might be necessary.

I said hi, then thanked him for coming to the conference and asked if there was anything he needed, such as a private room with a phone. We had arranged for a block of rooms for just these kinds of situations. "No," he said, seeming deflated or even a bit depressed. "I'm fine right here, Dan." Perhaps he was tired of doing all of these show-and-tells. Perhaps he had more weighty matters on his mind. I'll never know what he was thinking, since he snapped to it and did a fabulous job at the meeting, but I remember it as a bizarre—and somewhat sad—moment.

Bernie's dinner keynote address was a huge hit. Too many investors showed up, so we had to wheel TV sets out into the hallway to accommodate the overflow crowd. In his speech, he didn't let slip any unusual estimates or display any slides showing changes in the revenue projections. No, he simply made fun of my height, as usual, and then went on to his favorite topic—the value of WorldCom shares.

"They put these podiums low enough for Dan to see over," cracked Bernie, who stood six feet three. "I can't see my papers."[3]

I don't think Bernie ever spoke into a microphone in my presence without playing the height card. He loved mocking people, and with me it was always the short-guy thing.

Bernie went on to ask the audience if it wanted to play "Do You Want to Be a Millionaire?" in a nod to the then-hot game show *Who Wants to Be a Millionaire.* "If you do," he said, "go out and buy 42,000 shares of WorldCom stock and, by the end of this year, you will be a millionaire."

The stock was then trading at $45 a share, so, although I didn't figure it out immediately, it turned out he'd made a mistake. In trying to explain how owning WorldCom stock would make you rich, he'd said you should buy nearly $2 million worth of WorldCom stock in order to end up with $1 million. Ironically, by the end of that year, WorldCom's stock would fall by about 50 percent, proving Bernie right. Maybe he really wasn't very good with numbers, as his defense attorneys would later claim at his trial. Or maybe he knew what difficulties lay ahead and was giving everyone at my conference a between-the-lines heads-up. We'll never know.

Bernie went on to discuss how business was booming for his company. "Over the past year, we have had a very, very specific focus," he said. "We've added $4.7 billion in incremental revenue… we've increased net income by $2.6 billion, and we have invested about $8 billion…to further improve our network…. We've also integrated in the last year MCI, and have exceeded the synergy targets in every quarter….We've agreed to merge with Sprint and Sprint PCS and we've invested in wireless data…. With[WorldCom shares] trading at or below market multiples, why wouldn't you invest and become a millionaire?"[4]

The audience ate it up. But anyone who chose that day to become a contestant on Bernie's game show would certainly end up wishing that just like on the real *Who Wants to Be a Millionaire,* they could call a friend for advice or use one of their lifelines to escape.

Two Minutes to Midnight

The next morning, as I walked up to the podium in the ballroom to introduce the day's first speaker, I felt a bit high. So much was

happening in this one spot at this one moment in time. It really did feel like the epicenter of the telecom universe and the dawning of a new century, and I was, for a few days anyhow, Dick Clark. Actually, the analogy to *New Year's Rockin' Eve* was a lot closer than I realized, because it really was two minutes to midnight.

Midnight, for Wall Street, actually did come on March 10, 2000, the last day of my conference. That day, the NASDAQ hit its all-time high of 5,049 and thereafter began its death swoon. But for those few days, we all, even skeptical me, still believed that there was more good stuff to come.

In part, that was because virtually every one of our scores of speakers said so. Among the most prominent of our scheduled speakers, in addition to Bernie, were Steve Case, CEO of America Online; Vinod Khosla, the red-hot Internet venture capitalist; AT&T's Michael Armstrong; and Qwest's Joe Nacchio. Enron's Jeff Skilling had signed on to come, but canceled at the last minute, citing a scheduling conflict. Almost all of them talked about the wave of insatiable demand for bandwidth, for high-speed Internet access over DSL lines, for anything that would make communications traffic grow faster.

Even the regulators were spouting the hype. Bill Kennard, chairman of the Federal Communications Commission, sounded as if he were running a startup as he quoted that old standby statistic from 1997: "We know from the wireline world," he said, "that Internet traffic doubles about every 100 days, and that's a wonderful thing."[5]

Kathleen Earley, head of AT&T's Internet division, filled in for Armstrong at the last minute. She talked about "the end of business as usual." "AT&T," she said, "is the only company with all the pieces in place to be able to win in this space…we're focused on exponentially increasing the number of eyeballs, eardrums, and end points to our network."[6] Even the superlatives had superlatives.

The other thing that really amped this conference was the ever-flapping gums of Joe Nacchio. The speculation continued to swirl over whether Deutsche Telekom would bid for Qwest and whether the offer would include US West. Both Joe and Sol Trujillo, US West's CEO, were on the agenda to speak.

Qwest had confirmed on the evening of Sunday, March 5, just a few days after the rumor had interrupted my skiing, that it was in talks with a "major telecommunications company," which everyone believed to be Deutsche Telekom. Deutsche Telekom and its chairman,

Ron Sommer, had said nothing on the record. Just a few days earlier, Sol had announced that he would retire upon closure of the Qwest merger, which was supposed to happen within the next few months. "Joe and I have different styles, different approaches," he said in an interview with *The Denver Post.* "There's [*sic*] some things we don't agree on. My belief is a CEO should have his stamp on it, and a company can't have two different stamps on it."[7]

All of this made for a delicious drama that would have worked on *The Guiding Light* if only Joe and Sol had been better looking. You could almost hear the syrupy voiceover and the melodramatic music: were the two going to kiss and make up, or would the Plaza be the site of a brawl between two rich guys in suits, with other rich guys in suits betting on the action? I certainly hoped that they'd play nice, since that would push US West shares up and narrow the arb spread. This would make my mountaintop call look very good indeed.

On the other hand, all of this tension certainly heightened the intensity of the conference and pleased CSFB's senior management immensely. They loved the tidbits of news that allowed the salespeople to go out with what are called "proprietary calls" to the buy-side clients. And they really loved having the opportunity to introduce CSFB's top dogs—CEO Allen Wheat; head of banking, Chuck Ward; and others—to the telecom CEOs, otherwise known as potential banking clients, speaking at my conference. Next to technology, telecom was bringing in the largest banking fees to Wall Street firms, and with the Sol and Joe theatrics, our conference was the hottest show in town.

Qwest's Joe Nacchio arrived at the conference on Thursday, although he wasn't scheduled to speak until Friday morning. He came early just to hang out, or maybe to talk still more. During the late-afternoon cocktail hour, Joe gathered up a large group of investors as well as a bunch of journalists who had been following him around like puppies, hoping he'd give them some more information about Deutsche Telekom. He discussed—loudly—how he loved US West but felt its top managers were too resistant to change. He claimed he was not in a major fight with them, but that they needed to understand that the telecom world of the future required faster decision-making and they needed to replace old, bureaucratic habits with newer, more entrepreneurial ones. Everyone nodded vigorously. This was, after all, the mantra of the new economy.

Just then, someone noticed what Joe was drinking. "So you're drinking German beer," the investor said. "Does that mean a Deutsche

Telekom deal is imminent? Would you like to sell to them? What's your minimum price and is US West in or out of the deal?" It was a mouthful, but investors tend to blurt out all their questions at once, figuring they'll never sneak in another one with so many other people angling to get a word in.

Joe just looked at his beer, smirked, and said, "Oh, sure, I have a new-found fondness for German beer. It's really quite good, you know. It's a lot better than that Rocky Mountain beer." In one casual comment, he had managed to dis his original merger partner, Denver-based US West, while kissing up to his new suitor, Deutsche Telekom. He was fueling the fire, and he knew it.

Whatever the truth, it made for great theater. Virtually every fund manager, buy-side analyst, arb, and hedge fund manager with any possible interest in telecom had hightailed it to the Plaza as soon as they realized that Joe and Sol were at the conference and squabbling with each other through the crowds of people gathered around the coffee stations. They were all hoping to pick up some shred of information that they could use to make a quick buck.

I didn't really understand what game Joe was trying to play. It had been very reckless and even counterproductive to leak the potential Deutsche Telekom deal, in my view, because nothing had been signed and it could easily be called off. His implication that US West either would be left behind or would need to accept a lower price shocked US West shareholders, leading them to put enormous pressure on Sol Trujillo not to accept any change in the deal terms.

In my view, it would have made a lot more sense for Joe to quietly approach Sol and his board and discuss Deutsche Telekom's offer, explaining that if US West gave up a little on the amount Qwest had offered to pay for it, Deutsche Telekom could pay a big enough price to make shareholders of both companies better off. This seemed like an obvious approach, but Joe apparently couldn't keep his ego—or his mouth—under control. The share prices of Qwest and US West reflected the commotion, gyrating up and down with every interview and whispered—or shouted—conversation. Whichever paging transmitter was closest to the Plaza must have been in overdrive as buy-siders sent buy or sell orders back to their firms' trading desks and their traders sent back the latest gossip they'd heard.

None of this banter showed up on the webcast of the conference that was available to day traders, the general public, and even retail brokers. This was the "professionals only" part of the insider game,

but even the pros had no idea what was really going on: they were being manipulated by Joe, who himself may not have had a handle on what was about to happen.

Indeed, by the time he spoke to the crowds the next morning, his flirtation with a foreign suitor had come to an embarrassing end. The night before, March 9, Deutsche Telekom got cold feet. It rescinded its offer—if there ever had been one—and ended the talks. "Last night," Joe announced, somehow seeming totally unfazed, "Qwest announced that it was informed by a major telecom company with whom it has been engaged in discussions that it has withdrawn from discussions to acquire Qwest and US West based on positions taken by US West."[8] That day, Qwest's shares fell 12 percent on the news. US West fell as well, dropping 8 percent.

Ironically, that same day, the FCC gave its blessing to the Qwest–US West merger, and both sides tried their best to put a happy face on the sad debacle. "I know I'm in the middle of a merger. I know the reasons for doing the merger are true," Joe Nacchio said in a poor attempt at trying to move forward. "You gotta operate with what you have."[9] "In a conference call with reporters later that day, Joe claimed that while he and Sol Trujillo had "different views," the relationship remained "professional and cordial."

From what I'd seen, "professional" and "cordial" had only that day become part of Joe's vocabulary. Deutsche Telekom went on to buy Voice-Stream, now T-Mobile, the next year, and Qwest and US West consummated their marriage four months after the conference, just as the stock market began its radical shift downward.

My mountaintop call turned out to be the right one: the arb spread quickly narrowed, making anyone who took my advice a very healthy 38 percent profit in just four months. Those people would have bought US West shares at $72 per share on March 2 and sold them at $87 per share on June 30, the last day before the merger was completed and US West shares stopped trading. They also would have sold Qwest shares at $60 that same day and bought them back at $50 on June 30—making money on both sides of the trade. It was probably the best short-term call of my career. It was also my last good one.

The Beginning of the End

"WorldCom is the poster child for buying real things with fake money." That was a quote from a telecom consultant, Mark Bruneau

of Renaissance Strategy Worldwide, in a *Fortune* article that ran April 17, 2000, called "Bernie's Big Gamble."[10] True as this had been so far, WorldCom's amazing streak of acquisitions was about to come to a screeching halt—thanks not to any problems with investors, who wanted the company to buy the world if it could, but to the people companies don't think about when they're small and nimble—the regulators.

By June, we were hearing rumors that the U.S. Department of Justice's Antitrust Division was carefully looking at WorldCom's offer for Sprint and raising a lot of serious questions. I guess it made sense: the merger would concentrate much of the world's long-distance and Internet traffic, and unlike the participants in many of the earlier deals, these were very similar companies with similar coverage, so overall competition could be reduced. With the antitrust issues looming, I decided that it was time to think about downgrading WorldCom shares from my Strong Buy, or "1," rating. At this point, the vast majority of analysts had the same rating on the stock.

Ehud, Ido, and I sat down and tried to figure out the implications of WorldCom either abandoning Sprint and instead acquiring a wireless company, or buying Sprint but getting rid of a lot of its long distance business to satisfy antitrust concerns. An analyst named Scott Cleland, who ran an investment advisory service focused on federal government decisions, had recently predicted that the deal would not get U.S. antitrust approval. My Washington contacts saw this as entirely plausible as well, so I decided to work up some models reflecting several scenarios. They all came up with target prices for the stock that were lower than our current targets but still higher than WorldCom's current price. Yet the risks meant that a Strong Buy, or "1," rating was no longer justified.

So early in the morning of June 27, with WorldCom shares at $37.50, I lowered my WorldCom rating to Buy, the second-highest rating in CSFB's four-point system, pointing out that if regulators rejected the Sprint deal, WorldCom would still need to acquire a wireless business and it was becoming more difficult to grow via acquisition. Our report was titled "WorldCom: There Must Be Some Way Out of Here—But All Lead to Lower Target Prices." Its conclusion: "We believe the WorldCom/Sprint merger cannot proceed as originally proposed…. We are lowering our rating on WorldCom shares to buy from strong buy because all realistic scenarios yield significantly lower target prices…."[11]

I'm sorry I ever ran those alternative scenarios. I was far too mired

in my detailed models to truly grasp the looming disaster. They beautifully quantified different share prices in different situations but did not show how WorldCom had been using a series of ever-larger acquisitions to hide a slowing core business. The company was already beginning to spiral out of control. Though I wasn't mesmerized by the hype that had attracted many others to this stock, if I had been less analytic and more intuitive, as I had been in Tuscany and Vail, I might have better understood WorldCom's addiction to acquisitions and, perhaps, aggressive accounting methods to fuel its continued growth. My lower rating was still too bullish. It did not capture what lay ahead for WorldCom and its investors.

Just as our 22-page report, finished at 2:30 that morning, was hitting the wires, Attorney General Janet Reno and Antitrust Division head Joel Klein announced that the government was filing suit to halt the merger. "This merger threatens to undermine the competitive gains achieved since the [Justice] Department challenged AT&T's monopoly of the telecommunications industry 25 years ago," Reno said. The merged company would control 30 percent of the market for long distance services between the United States and other countries and a combined 51 percent of Internet traffic, the government said.[12] Faced with that pressure, WorldCom and Sprint announced later that day that they would withdraw the merger application and reconsider it after divesting certain assets. For all intents and purposes, the deal was doomed.

For me, the news came a day too early. If it had happened a day after my warning and downgrade, my clients could have saved serious money. But having it come out simultaneously meant that my call was useless to investors, as WorldCom and Sprint shares moved instantly on the news of the merger's cancellation. Sprint shares dropped 2 percent while shares of WorldCom gained almost 6 percent, rising $2.06 to $39.69. The following day, WorldCom topped $42 per share, while Sprint fell another $5.63 to $52. Indeed, hope sprang eternal when it came to WorldCom's stock. Within three weeks, WorldCom shares had risen even further, hitting $47 per share and making my downgrade look pretty bad.

IN PREPARATION for WorldCom's second-quarter earnings results, we did everything that we could do in advance to get a written report out quickly. That meant setting up a pre-written template of a short report, which we called Quick Notes, that we would rush out as soon as we got the numbers and assessed whether we needed to change our

forecast or rating. Our goal was to get a Quick Note out within an hour or two of a company's press release, but it was always tricky. Even after we'd done our bit, we had to get compliance to approve it, which took at least 30 minutes and sometimes over an hour.

At 8:16 on Thursday morning, July 27, 2000, WorldCom's second-quarter earnings hit the wires. Ehud, Ido, and I scurried to scan the press release for any telling words, then crunch the numbers, and get the Quick Note together before Bernie and Scott held an investor conference call at 10:00 AM. We quickly realized that WorldCom's earnings were a penny shy of our forecast, and that revenues had grown only 13.3 percent, below our 14.0 percent forecast, with the shortfall coming almost entirely from Internet revenues.

One of the reasons investors had such unyielding faith in Bernie and Scott was that they delivered time after time. Before this stretch of disappointments, WorldCom had had an incredible record of meeting or beating expectations. Yet this was the second quarter in a row that they hadn't hit the numbers. I was concerned, but these dribs and drabs of bad news still seemed to be just that. Still, I had to react: the markets would be opening at 9:30 AM, which meant clients and salespeople would need time before then to get their orders ready. So I summarized the shortfall, lowered my revenue growth forecast for 2000 to 13.5 percent from 14.0 percent, and recalculated the target price, figuring I'd done the best I could in the time allotted. The changes were not enough to justify a further rating reduction, in my view.

But I looked pretty pathetic when at 8:49, just 33 minutes after WorldCom's press release came out, Jack's clients began to receive his 10-page report full of lengthy analyses, tables, and charts. It was amazing in its detail, which was far more voluminous and precise than anything in the company's press release, and even more detailed than anything that would be mentioned in the conference call, which wouldn't take place for another hour. Some clients forwarded the e-mail to me almost immediately. Scott's earlier assurance to me that "that stuff is not going on anymore" with Jack sure looked like a lie.

"I can't believe what is going on here," I raged to my team. "In order to understand the WorldCom quarter in its full details and to know what my clients already know, I have to read a competitor's report! Am I that bad an analyst," I asked sarcastically, "or is there something shady going on here?"

To be fair, it was not illegal for Jack to publish whatever

information he had, provided he did not receive it while over the Wall and working with Salomon Smith Barney's bankers. Assuming he made the information available to everyone simultaneously and thus didn't favor one client over others, he would have been following the rules of the Institute for Chartered Financial Analysts, an organization that certifies securities analysts. The wrongdoing, if it existed, was on the part of WorldCom if someone there indeed passed the results to Jack before announcing them to the public, which is what I believed was happening. There was no way he could have absorbed, analyzed, written, and gotten compliance approval in those 33 minutes.

I've never understood what WorldCom gained by giving Jack advance notice and information. First, there was the legal risk; second, this treatment bolstered his credibility to the point that people believed him more than WorldCom's own executives, as we saw with the revenue-growth story at his conference earlier in 2000. It worked to the detriment of Jack's competitors, including me, but wouldn't a company want as many voices on the Street as possible? What if Jack changed his tune on the company? Or did they have a reason to believe that Jack simply wouldn't ever change his tune, and thus this was the best possible way to ensure that there would always be at least one loyal cheerleader, even if the home team was getting routed?

What I kept butting my head against was the reality that Jack's style of doing business was now *the* style of doing business, wrong, right, or what have you. Back in May, *Business Week* had published a huge feature on Jack titled "The Power Broker," written by Peter Elstrom. With an opening spread featuring Jack, hands on hips, looking off to the side as if he were gazing into a crystal ball, it somehow managed to burnish his image at the same time that it exposed a lot of the lines he was crossing, many of which he readily volunteered. "You don't know Jack?" it read. "You should. In the past four years, as the deregulated telecom marketplace has exploded with possibilities, so too has the influence of Jack Benjamin Grubman."[13]

The article discussed his influence on the banking side, asserting he'd played a major role in bringing in $5.7 billion in telecom IPOs to Salomon Smith Barney since 1997, and wondered aloud about the conflicts of interest he seemed to invite. It also mentioned that he'd embellished his résumé, saying he'd graduated from MIT when it had been Boston University and that he'd grown up in tough South Philadelphia, home of Rocky Balboa, when in reality it had been a not-so colorful middle-class neighborhood in Northeast Philly. "At some point, I probably felt insecure," he said by way of excuse.

The story continued: "'What used to be a conflict is now a synergy,' he says. 'Someone like me who is banking-intensive would have been looked at disdainfully by the buy side 15 years ago. Now they know that I'm in the flow of what's going on. That helps me help them think about the industry.'"

When asked about such close ties affecting objectivity, he scoffed. "'Objective? The other word for it is uninformed,' he said."[14] I read the piece and said to myself—and to anyone who would listen—this guy was a reckless fool and might end up in jail, pulling others down with him.

Our "uninformed" team spent a very long day and grueling night preparing an in-depth review of WorldCom's results. The report was published the next morning at 7:30 AM, almost 23 hours after Jack's tome had hit the buy-side's e-mail boxes. And we still didn't have all the information he had. The only thing I knew for sure was that if anything else started to go sour at WorldCom, I wasn't going to be the first to know.

The Guide-down Game

I couldn't have been more right. About a month and a half later, on September 6, Ehud and I were in a taxi, on our way from the Kansas City Airport to Sprint's headquarters for a day of meetings. My pager went off with a message from Ido that WorldCom was buying Intermedia, a startup local carrier and Web-hosting company, and that a conference call had just started. Fortunately, we had a long drive from the airport, so we each called in on our cell phones. We'd missed Bernie's introduction, but Scott Sullivan had just come on to describe how the purchase would impact earnings. He said it would reduce 2001 earnings per share by 10 to 12 cents, which translated, he said, "into $2.13 to $2.15 a share." Everything at WorldCom, Scott said, remained on track.

Ehud and I looked at each other, mystified. "On track?" I mouthed silently. Our estimate had been $2.42 a share, which we knew was just a tad above the $2.40 the company had been comfortable with on July 27, when it had reported its second-quarter results. So with this deal, Scott's numbers should be down to around $2.28 to $2.30, not the much lower range Scott had just predicted.

My first reaction was to be furious with Ehud, because I jumped to the conclusion that WorldCom had guided earnings downward, perhaps while I was on vacation in August, and that somehow he had

missed it. I put my hand over the phone and snapped "What's going on? Are our estimates way out of the range or what?" Yet I also suspected that Scott had a way of always assuring everyone that everything was fine, even as it was being altered for the worse.

Ehud, though relatively new to the business, was razor sharp and rarely made a mistake. "I'm almost positive they haven't altered their guidance since the call at the end of July, and it was $2.40 then. That I know for sure." I asked what the First Call consensus estimate was—an average of all the analyst estimates—but he didn't know offhand and suggested having Ido or Julia check it back at the office.

"We don't have time," I said. "If he did something sleazy, I've got to expose it on this call when we get to Q&A." So, risking the embarrassment of having missed something that everyone else knew, I asked the following question on the call with some 1,000 investors listening in:

"Scott, could you please repeat your EPS guidance for 2001? I'm not sure I heard it right. Did you say the new range is $2.13 to $2.15, down 10 to 12 cents?"

"Well, Dan, not exactly," Scott said. "I said down 10 to 12 cents from the expectations of the major people who follow the stock."

"That's weird," I said. "My estimate is $2.42, so I've lost 15 cents or more somehow."

"Dan, I don't know why your number is so high," Scott said, essentially confirming his lower numbers. "Others are at $2.25."

As we pulled up to Sprint's headquarters, I shot another look at Ehud. Did he mess up royally, or were we exposing the CFO of one of the largest and best-loved companies in the world as a liar? We had to go to our meetings, so we'd have to wait until later to find out who was right. In the meantime WorldCom's shares were dropping like a lead balloon. Perhaps people were going back and looking at their models and realizing that Scott had just sneaked in a 15 cent, or 6.3 percent, cut in his earnings estimates for the year, a shocking half-billion dollar reduction in WorldCom's earnings outlook. WorldCom shares fell 17 percent from $36.93 to $30.56 and Intermedia shares soared 34 percent from $22.87 to $30.69 over the next three days.

When we were able to call Ido and get the First Call numbers, we found that Ehud was right, as usual. The average or consensus earnings forecast remained at $2.40—although it turned out that three

analysts—Jack, Frank Governali of Goldman, and Eric Strumingher of PaineWebber—had lowered their estimates to $2.25 in the previous month. Jack had been first, of course, on August 4, while Strumingher had come down just a week ago, on the 28th. The other 16 of us were either on vacation during much of August and out of touch with the company or were not privy to the real story. Scott may have guided Jack down first, and the other two, being smart and attentive, may have seen his change and contacted the company to try to figure out what had made him do it.

Clearly, if there was bad news, WorldCom preferred it to come out of the mouth of its biggest supporter. It's also possible that he did some good analytic work on his own, finding some issues that jeopardized WorldCom's ability to meet its $2.40 estimate and writing it up for all to see. In that case, the rest of us had simply been asleep at the switch. Still, at this point, I saw an inside job in just about everything that happened with WorldCom or Jack. Amazingly, we tried to listen to the tape of this call about a day later, and found, to our surprise, that my questions and Scott's answers to them had been mysteriously deleted. The rest of the Q&A session remained unaltered. But at least 1,000 people had heard our exchange and Ido had made his own recording anyway. What a Rosemary Woods moment.

None of this was necessarily illegal—just underhanded, unethical, and unfair—but it was about to become so. Just the month before, in August of 2000, the SEC, under Chairman Arthur Levitt, had approved a new rule aimed at ending exactly this process of "selective disclosure." This meant, according to the SEC, situations "whereby officials of public companies provide information to Wall Street insiders prior to making the information available to the general public."[15] Levitt had correctly argued that such leaks, or "whispers" as they were known, disadvantaged not only the general public but also those professionals who were not the first to get important information from a company.

Once Regulation FD (Fair Disclosure) went into effect in October of 2000, all of these whispers from a company to an analyst became illegal. A lot of analysts—and their bosses at their firms—worried that the new rules would make it very hard for them to do their jobs. These new rules would make clear just how much of their vaunted expertise came from having access to executives and information that others didn't. As experts able to interpret news and information, research analysts still had value. But for anyone who relied on tips rather than analysis, Reg FD meant big trouble.

I supported FD as one of the few things Arthur Levitt had done since coming into the job in 1993 that might help investors. I figured that it would make analysts do their own homework instead of relying on management guidance. I also thought it would have an unintended effect of creating more stock-price volatility because companies would hold back information until there was enough to merit issuing a press release, which would then create a shock. This was because Reg FD made it no longer acceptable to do a slow leak à la MCI in the old days.

A Week from Hell

By the Fall of 2000, it was obvious that what many people had believed was just another protracted episode of volatility was, in fact, a true market crash—at least on the NASDAQ, which had dropped 39 percent since its March 10 peak. Dot-coms such as Pets.com and Boo.com were in dire straits or had already gone under; layoffs had replaced luaus; and tech funding was rapidly drying up. But even though tech and telecom had in many ways become fully entwined, now the two paths seemed to be diverging, in my view.

I had been cynical about many of these tech startups from the beginning, so I didn't find the news of their demise particularly surprising. So many of the newly public dot-com companies were just ideas, with hardly any customers or assets and virtually no barriers to entry by other competitors. The telecom companies that I covered, on the other hand, were for the most part proven businesses with real customers, revenues, cash coming in, and assets. And those that weren't, like Qwest and Global Crossing, had purchased real companies in US West and Frontier, which hedged their new-economy bet. So while the phone companies weren't looking nearly as good as they had early in 2000, they were still looking pretty good.

But the long distance sector of the market was suddenly in real trouble, starting with AT&T. Mike Armstrong's attempt to plow over the soil and grow an energetic new culture at AT&T was failing. Having cobbled together a telecommunications company that seemed to have all the parts—long distance and local, voice and data, wireless and wired, video and high-speed access—in the hope of getting a head start on the Baby Bells, Armstrong found that integrating them was a lot harder than buying them. Huge turf wars inside AT&T continued to rage among people fighting to defend their various fiefdoms, and the company was filled with antiquated computer systems that didn't talk

to each other and people running them who didn't either.

For example, even though AT&T had purchased McCaw in 1993 and made it the core of its cellular offering, AT&T Wireless and AT&T long distance customers were still, seven years later, not receiving one unified invoice because the two units were still using different billing systems. Armstrong had been trying hard to bring some entrepreneurial verve to this company, but it turned out that AT&T didn't have the ability to absorb it in its DNA.

At the same time, competition had intensified in the traditional long distance business, the business that provided virtually all of the company's earnings and cash flow. There were just too many rivals now, ranging from the Bells to WorldCom to Qwest and numerous wireless companies offering free long distance. Ironically, it was AT&T that, in 1998, had first introduced free long distance for its wireless customers, called the One Rate Plan. This had quickly turned long distance into a commodity, with perhaps the most corrosive effect on AT&T itself.

By October of 2000, AT&T's shares were mired in a decline that had begun shortly after the announcement of the AT&T Wireless IPO back in 1999. On October 4, 2000, *The Wall Street Journal* ran a story on the front page of its Money & Investing section about Jack's ill-timed upgrade of AT&T, hinting that it might hurt Salomon Smith Barney's banking business, which had hit a phenomenal $350 million in fees in 1999. It read, "everyone seemed to win—everyone, that is, except investors who heeded his call and bought AT&T stock."[16]

Incredibly, two days after the article appeared, Jack reversed himself again, downgrading AT&T shares to a "2," or Outperform. The downgrade shocked most of the media and Salomon Smith Barney's brokerage clients, but it was old news for many of the professionals. Back in May, when Jack rated AT&T shares a Buy, or "1," and just after the AT&T Wireless IPO was completed with a $63 million payoff to Jack's firm, I received an e-mail from a client who worked for a hedge fund. "Fyi, Jack is pissing all over AT&T," he wrote, suggesting that Jack's private comments to some institutional investors were far more bearish than his written reports, which Salomon Smith Barney's brokers and individual investors relied upon.

Jack's tactics were finally attracting some negative attention. I was happy about it, and I wasn't the only one. Just after the *Journal* article came out, I got an e-mail from Frank Quattrone. Ever the competitor,

he saw the negative articles about Jack as a major opportunity.

"Hey," he wrote, "Grubby-man is getting drubbed on the att round trip. Major oppty for you to crush him for good. Planning any major marketing/advertising events?"

Unlike Frank, I wasn't much of a self-promoter, so I simply responded, "Any ideas?" and the discussion ended there. I was glad I wasn't the only one noticing Jack's diminished status.

It was at about this time that AT&T's Armstrong decided to throw in the towel on his cosmic strategy of integrating voice, video, and wireless into one bundle of services. Instead, he decided to break up AT&T all over again by dividing the company into three completely separate companies—AT&T Long Distance, AT&T Wireless, and AT&T Broadband (cable TV and modern services). Unbeknownst to me, CSFB and Goldman bankers had been brought in to plan the restructuring. On October 23, I was called over the Wall, along with Goldman's telecom analyst, Frank Governali, to hear a preview of what Mike and his CFO, Chuck Noski, would say the next day at a hastily arranged analyst meeting.

We met secretly in AT&T's virtually uninhabited downtown Manhattan offices at the foot of Sixth Avenue. Almost all of AT&T's executives worked out of the New Jersey headquarters, but the company had kept the building to use for New York meetings. They had draft slides ready to go and wasted no time getting down to business. I had had no advance briefing from Chris Lawrence, CSFB'S AT&T banker, or his team, so this was all brand-new to me.

I was amazed that Mike was giving up on integration. I asked why a few different ways, but he only said that the stock had been pounded and that the market wasn't giving credit to the company's long-run strategy. In effect, he was saying that the market's myopia was forcing him to abandon his grand transformation plan. He seemed exhausted more than frustrated. Yet by the next morning he would be back to his ebullient self, confident smile and John Wayne voice at the ready.

And then AT&T's CFO, Chuck Noski, told Goldman's Frank Governali and me what Mike Armstrong was planning to announce about earnings and revenues. It was horrendous. The competitive pressures from WorldCom, Sprint, several new startups, and, of course the Bells, were causing AT&T to lose share and cut prices at a far faster pace than expected. I was suffering along with the company,

having recommended AT&T at Merrill almost two years earlier, at a post-split $52 per share. AT&T shares had fallen 48 percent since then and were now trading at $27.

With the exception of IDB back in 1994, upgrading AT&T had been my worst stock call ever, and things had only gotten steadily worse. But now, with me over the Wall and CSFB likely to be advising AT&T for the next year or two, I didn't think I should be issuing any opinions. CSFB's compliance officers agreed, so I was instantly restricted from commenting on AT&T and its shares. From October 23, 2000, I couldn't write or say a word about AT&T. As frustrating as this was, I was also relieved: my call had been a disaster and this, at least, stopped the bleeding.

The analyst meeting didn't go over well. AT&T shares fell another 13 percent. And the market was beginning to realize that the disease that was afflicting AT&T—brutal competition for long distance services, the move to make long distance free for cellular calls, and the muscle of the Baby Bells—was beginning to give the other long distance companies more than a sniffle as well.

Except, that is, for good old Qwest. Exactly a week after AT&T's dour earnings announcement, Qwest held an all-day analyst meeting in Manhattan, at the Waldorf-Astoria Hotel. As we sat in the Grand Ballroom awaiting Joe Nacchio's talk, the mood was defiantly confident. It seemed the polar opposite of the morose tone of the AT&T meeting. Clearly, whatever one thought of Joe, he was doing something right. Qwest continued to thrive, reporting robust and on-target growth in revenues and operating cash flow.

Suddenly, the lights dimmed and the stage lit up. Out marched Joe, dressed in full Australian outback regalia and pith helmet, to the overdramatic sounds of the music from the hit TV show *Survivor*. Arrayed around the stage were a series of burning torches, each one representing one of Qwest's competitors. There was a torch for AT&T, another for WorldCom, and one torch each for Sprint, Global Crossing, Verizon (the former Bell Atlantic), and several of the other Baby Bells. You can imagine what came next. Nacchio, completely in his element, traipsed merrily across the stage to each one of his rivals' torches and delivered a short monologue on what was wrong with each one of them. Then, with evident pleasure, he snuffed out each of their flames.

"I don't know what's wrong with the other guys in the industry," he repeated over and over during the course of the meeting, "but

Qwest is doing just fine." Yes, he acknowledged, the economy was soft in a few regions, but US West's regional economy was resilient and other growth sources, such as data, Internet services, and wireless services, were more than compensating. Then there was the stability of US West's local business, which was still more or less a monopoly. If there was to be only one Survivor, he assured all of us, it would be Qwest.

While the skit was silly, those of us still recommending Qwest's shares found the meeting somewhat of a relief. There were still some winners in this sector, and what seemed to be happening was that the day of reckoning for the incumbent long-distance companies that I had warned about five years earlier was upon us. Some companies were getting their lunches eaten; others were prospering. It wasn't a slowdown in overall demand as much as a Darwinian shakeout.

But that sense of relief didn't last long. Just as I was leaving the Qwest meeting, I got word that WorldCom was holding a surprise analyst meeting in New York the next day, November 1. I figured it was going to be bad news, and it was. I intentionally arrived early at the meeting, about 6:45 AM, to get the press release as soon as it came out at 7:00 AM. It announced that WorldCom was going to create two, yep, tracking stocks, one for services to businesses and one for services to consumers.

More significant, it also was reducing its growth projections due to "intense pricing pressures, unfavorable foreign exchange rates and the shift of consumer voice to wireless technologies."[17] Though the new targets were dismal, it sure looked as if Scott Sullivan and his team had done extremely detailed analyses of WorldCom's various lines of business.

Wow, I thought, these are huge cuts. The water torture of the past three quarters had turned into a downpour. I knew this would be very bad for WorldCom's share price, and I knew I needed to tell CSFB's sales force as quickly as possible. But first I wanted to get a better understanding of what was happening. Bernie was not around yet, but I found Scott and asked a few questions about what was driving the bad news. He had some pretty logical answers that were consistent with Armstrong's answers a week earlier. When I asked about his new forecasts, he said he would not talk about them until Bernie made his opening remarks. Realizing that I wasn't going to get much more from him and that CSFB's morning meeting would be ending soon, I pulled out my BlackBerry and started to type up an e-mail to CSFB's sales force.

With its wireless e-mail capability, the BlackBerry had completely transformed my job: no more racing to beat my competitors to the phone banks, no more having to wait until a meeting was over to get my thoughts back to my team or the sales force. I decided to immediately downgrade WorldCom's shares for the second time this year, this time from Buy, or "2," to Hold, or "3." I also dramatically lowered my earnings estimates for 2001 to $1.10 per share, down 46 percent from my prior estimate of $2.02. A huge $2.7 billion dollars of annual profit had just disappeared.

At the meeting, even Bernie seemed humbled, a shadow of his former swaggering self. "We recognize we have let you down," he said, promising to do better. "When I was 16 years old, I was a six-foot-three, 130-pound kid trying out for the high school basketball team. I was one of six Anglo-Saxon kids among a Native American community. Our coach didn't speak English. I was competing for starting center against a kid the same height but 100 pounds heavier. The coach threw the ball out into the center of the court and said whoever comes up with the ball is the starter. I came up with it. We are going to come up with the ball too. We are going to right this effort as never before."

Later, he was a lot less sanguine. "People have a legitimate right to ask if I'm the right person to lead the company," he told reporters after the meeting.[18]

WorldCom's announcement was an unmitigated disaster for virtually everyone in the investment world. Lots of professional fund managers still owned the stock, which had already been suffering and was about to get crushed, and virtually all Wall Street analysts were still recommending it. The only thing that made the pain bearable for us was the fact that this business was all about comparative performance. So if we all got hosed, at least we were all in it together.

A day later, two other investment banks downgraded WorldCom shares: Merrill Lynch, with my former colleague Adam Quinton, and Wachovia Securities, both from "Buy, or "1," to Neutral, or "3." Salomon Smith Barney and J.P. Morgan were handling the tracking-stock deal, so I assumed they would not comment.

But I had forgotten once again about the SEC's No-Action Letter. Jack reiterated his Buy, or "1," rating, in a lengthy report approved by his compliance department, as did the analyst at JP Morgan. By this point, compliance lawyers could drive an oil tanker through the loopholes in the SEC regulations, with plenty of room left over for an

investment bank and its analyst to do whatever they wanted. Thanks to the No-Action Letter, analysts knew they could write about virtually anything they pleased, conflict or no conflict, with no fear of getting in trouble. Arthur Levitt's sleepy SEC appeared to pay not a whit of attention.

What had at first seemed like a bit of softness for one company had mushroomed into a calamity for all of the long distance incumbents. On November 3, Sprint held an analyst meeting that was a virtual carbon copy of the others, except it didn't announce a tracking stock, because it already had one. I was of two minds as I tried to digest the news. On one hand, I was devastated to have missed the biggest and most bearish nine-day period ever for the incumbent long-distance companies. Dammit, I thought, if only I had stuck with that position that I had launched with a bang back in July of 1995 and never upgraded those stocks to Buys. I should have ignored all the data and Internet hoopla and stuck to my narrow argument that the voice long distance business was going to get creamed.

On the other hand, I felt a kind of guilty vindication. My overall theory that the Baby Bells were the best situated to compete in this market had been strengthened, not weakened, by what had just transpired. Now WorldCom, Sprint, and AT&T were too weak and too distracted to attack the local market, giving the Baby Bells still more power.

In our insular Wall Street world, I suddenly looked a lot better than a lot of my competitors. Clients began calling to congratulate me, citing both my relatively early downgrade of WorldCom and the fact that my argument of five years ago was beginning to bear fruit. Jack, they said, was no longer looking as savvy as he had just a few months earlier. An important shift was happening, we all intuitively understood. What we didn't yet understand was exactly how seismic it would become, and how devastating the results would be.

9. Crash and Burn

2001

The victory couldn't help but feel hollow. When I came home and told Paula the news, she congratulated me, but it didn't take long for her to ask, "So what's going to keep you going now?" It was a good question. The twin towers were down, the markets were down, much of the telecom industry was down, the reputation of analysts was down, and even Jack Grubman was on the way down. Every part of my professional world was unraveling, from the companies I followed to the firms I worked for.

The Crash

"MR. REINGOLD," the voice mail message began, "I saw your report today about WorldCom." I didn't know who he was, but his voice had an ominous tone.

"Mr. Reingold, you are making the stock go down with lies about the company. I know how you Wall Street firms work. You guys short the stock and then go out there with your negative reports and force the stock down." By now, he was starting to breathe heavily, growing more and more agitated. "I'm going to take you and your firm to court, Mr. Reingold," he screamed. "I am not going away. You guys and all the others like you will *pay*! See you in court!" He hung up.

The first time this man called me was in the middle of 2000, after my first downgrade of WorldCom's stock and after I had begun to regularly reduce my earnings estimates for the company. Every sell-side analyst on the Street got calls from such people on occasion, and as the stock market began to teeter and tumble, there were understandably many more of them. By October 2002, when the market hit its bottom, the Dow Jones industrial average had lost 38 percent from its high, while the NASDAQ composite index had tumbled a horrifying 78 percent. Some estimates put the total value of stock market losses at about $8 trillion.

Yet today, after analysts have been excoriated—and rightfully so—for remaining relentlessly sunny as the clouds on the Street began to build, there's a part of the story that is rarely understood. That's the unslakable thirst of investors—whether pros, individuals, or that new breed, day traders—for bullish commentary, as if such commentary could make "the value of these stocks…perpetually rise," in Jack Grubman's words of 1999. My irate caller's rant came from the misplaced belief that analysts had the magic wand to reverse a stock's decline, simply by saying it wasn't so. He saw us as all-powerful, when we turned out to be anything but. In a panic-driven market, no one person or group could halt an avalanche. The true believers couldn't, and wouldn't, accept this reality.

A few months later, in late 2000, the same man called again and left even more threatening messages, full of venom. I was unnerved, so I forwarded the message to CSFB's legal and security departments. The folks in security actually hired a private detective to find out more, and after a little bit of digging, they discovered that he was an attorney in a Boston suburb with a history of class-action lawsuits against Wall Street. That made me relax a little bit. At least, he seemed to use legal means to fight his battles and wasn't, I figured, some wacko who was going to blow me away one morning as I walked into the office.

But what was most disturbing—and eye-opening—was that he seemed utterly convinced that we at CSFB were artificially forcing down WorldCom's shares. The great irony, of course, is that WorldCom's problems were only beginning. While he was apoplectic that WorldCom's stock had fallen from a high of $64 to $15, the company was essentially bankrupt already. I'm sure he now wishes I'd been more negative on the stock at the time, not less. I certainly wish I had.

There had been countless press stories romanticizing the stock market and the brilliant minds behind it, and now, as the indices began to sink into an unforgiving quicksand, the pendulum swung to the other extreme. First came the dot-com debacle. Pets.com was one of the first newly public American companies to go under, in November of 2000, with hundreds of others soon to follow. A bitterly funny Web site, Fuckedcompany.com, sprang up to spread the latest gossip about each failed dot-com and the number of layoffs associated with it. In a split second, the market psychology on these new companies switched from "anything is possible" to "nothing is real." There were still jokes, but the tone changed from giddy silliness to gallows humor.

I watched all this through the eyes of a bystander, or so I thought. As the dot-com meteorites quickly disappeared into a black hole, it still seemed relatively easy to believe that what was going on *there* was a South Sea Trading Company–style bubble bursting, while what was happening in telecom was simply a classic shakeout. People were not going to stop talking on the phone, obviously. And businesses were not going to stop sending information and data from one place to another via the Internet either, though the traffic wasn't as much as prophesized.

Sure, the Telecom Act of 1996 was doing significant harm to the incumbent long-distance companies, and sure, the bull market had funneled too much cheap money to the startups, but the Baby Bells still seemed to be on solid ground and Qwest had the advantage of owning a real phone company in US West. Even Global Crossing's business came mostly from overseas, where competition wasn't as intense.

What an incredible piece of self-delusion. No one had realized it, but our sector was headed for a collapse that would make the dot-com crash look like a fender bender.

As 2001 dawned, some disturbing events began to hit much closer to home. The first telecom group to lose favor was the startup local telephone companies that had sprung up to meet the new telecom needs of the dot-coms. Companies such as ICG, Winstar, Metromedia Fiber Network, McLeodUSA, and XO Communications, which provided local phone and data service in competition with the Baby Bells, began to buckle under the weight of their enormous debt, which they had easily raised from investors who believed they would fill a massive unmet need for communications services.

Mark Kastan and I both thought that the winners among them would be the ones that built real networks and were not dependent upon the Baby Bells to connect to customers. But it turned out that building local infrastructure—that last mile to the home—is extremely expensive and takes a very, very long time. And although the startup local carriers were more than flush with cash thanks to the generous stock and bond markets, the money came so easily that they wasted a lot of it on fancy headquarters and massive advertising programs and neglected their buildouts.

Ultimately, the dot-com collapse had a domino effect on the local carriers: when the dot-coms' capital dried up, they cut back their expansion plans and canceled orders for communications lines. The

Bells, with their healthier finances and well-diversified customer base, weren't affected nearly as much.

The local-carrier collapse hit Jack the hardest, because he continued to strongly recommend almost every one that did its banking with Salomon—which was most of them—even as the stocks began to tumble. The first to file for bankruptcy was ICG, in November 2000, followed, five months later, by Winstar Communications, a company that had been a top pick of Jack's and of Mark Kastan's. Although Mark was more selective in his recommendations than Jack, all of us were slow to see what poor competitors a lot of these companies were and how quickly the funding would dry up. But as the year went on, it was Jack's reputation that took more and more of a hit. He'd always claimed to be in the co-pilot's seat with these companies. So why didn't he know they were about to crash, his critics asked?

Yet as strange as it may sound given the speed with which the market fell apart, the whole thing was pretty anticlimactic. The year 2001, for me, was a lot like being stuck in a ship taking on water. There was no single event that told everyone that it was over. Instead, we experienced a slow-motion decline that at first seemed strange and later seemed somehow normal. The Dow had peaked in early 2000, but fallen and risen several times since then, creating a sense that this might still be a short-term correction rather than a major bear market. And the true believers of the Internet kept on talking. Although fewer people were listening, those believers provided a final lifeline for the investors who hadn't yet realized that a major chunk of their life savings might have disappeared.

With no real idea how long all of this would last, most of the Street analysts just dug in and stuck to their investment theses. For me, that meant I continued to talk up the Bells and Qwest and to talk down WorldCom, the company most exposed to the downward trends in long distance. I remained restricted on AT&T and couldn't talk or write about it. I think that my jubilation over the first part of my longtime arguments having come true—the incumbent long-distance companies were in big trouble—may have kept me from fully understanding just how all-encompassing the global glut of telecommunications services would be. I still believed that there would be survivors in this industry, and that one of them would be Global Crossing, which I was recommending with a Buy, or "2," rating.

For Jack, sticking to the program meant continuing to pound the

table for his favorites—WorldCom, Global, Qwest, and virtually every local startup—and to steer investors away from the Baby Bells even though he now had Buy, or "1," ratings on SBC and Verizon, two of the three Baby Bells. The remarkable thing about Jack was that the worse things got, the louder he talked, as if he could make it so simply because he said so. It wasn't actually an unreasonable point of view, given that until now most people seemed to think he really did make the world turn.

The Show Must Go On

The 2001 CSFB Global Telecom CEO Conference took place in March, as always, but the tone was decidedly less exultant than it had been the prior year. Many months earlier, we had decided to move from the Plaza to the Grand Hyatt to better accommodate the crowds, but they were long gone. The NASDAQ had dropped a shocking 59 percent in the past year alone, taking along with it most of the telecom startups. We had 25 percent fewer people than the year before, but it was still a good turnout considering the huge snowstorm that hit New York on the first day. There was a lot of talking going on, but not a whole lot of deal making. The telecom world was coming to terms with the fact that not everyone was going to be a winner—and that, in fact, many were going to be big, big losers.

In the meantime, we had a show to put on. We didn't exactly party like it was 1999, but we didn't go into mourning either. In fact, our budget for the conference had been bumped up by almost 40 percent, to $2.3 million. Our attendees still expected a good show, and we obliged. We considered a lot of big names for our special entertainment, people like Sting and Seinfeld.

The going rate for these guys was as inflated as the stock of the executives they were performing for. Sting, for example, charged between $600,000 and $1.1 million, plus six first-class and nine coach round-trip plane tickets, 14 hotel rooms, ground transportation, and production. Seinfeld required a $550,000 fee, along with private aircraft or two first-class round-trip airfares, one hotel suite, and one single room. Not only would these guys bust my budget, they just seemed too ostentatious given what was happening in the markets.

We ultimately chose Harry Connick, Jr., at a "bargain" cost of $375,000 plus two first-class and 18 coach-class round-trip airfares, two suites, and 18 rooms, along with ground transportation and production costs. I thought he summed up the mood I was striving for—serious and classy. Instead of MP3 players, we gave out Motorola

walkie-talkies. It was still absurd—just not quite as absurd as it had been the year before.

We had to walk an odd tightrope in this image-is-everything environment. To come off as cheap would imply that CSFB was suffering, and my bosses didn't want to project that. On the other hand, too much bling would mean we were oblivious to what was going on in the world and in the market, and that, too, would come off poorly. Our marquee speakers were Ivan Seidenberg of Verizon, Qwest's Joe Nacchio, and Duane Ackerman, CEO of BellSouth. AT&T, WorldCom, and Sprint executives were nowhere to be found. The idea of being pelted with questions from 1,000 angry investors probably wasn't that appealing to them.

In contrast, Global's president, David Walsh, substituting for CEO Tom Casey, and Joe Nacchio were just as ebullient as could be. Joe exulted over the strong demand Qwest had seen in January, while Walsh confirmed the first quarter's positive outlook.

Perhaps because I was no longer recommending his stock, or perhaps because his stock was in free fall (having plummeted from $41 to $16 over the last year), Bernie Ebbers didn't speak at this year's event. Yet WorldCom was unquestionably the main topic of discussion in the hallways, as it had been everywhere I'd gone for the past few months. On January 22, 2001, *Fortune* published a piece, "Can Bernie Bounce Back?" that described him as down but not out and suggested that the company might make a good takeover candidate.[1]

I didn't know if anyone was truly thinking about buying WorldCom, but I thought it would be an incredibly stupid move to do so. My January report had reiterated my Hold rating, with the stock at $22.75, and said: "We remain on the sidelines on WCOM."

By the time of the conference, however, takeover rumors involving WorldCom were rife, particularly one that suggested that SBC might buy WorldCom. A reporter from Bloomberg News later that day asked me if I thought Bernie would sell the company for $35 a share, even though he supposedly had been looking for $50.

"In a New York minute," I said offhandedly.

"Who could afford WorldCom?" he asked.

"That's the problem," I responded, explaining that a buyer faced a slumping long-distance business, demoralized employees, and a long

regulatory review.[2] If that was Bernie's way out of the fix he was in, he was in big trouble.

Global's Insider Game

It should be obvious by now just how unevenly information travels on Wall Street. Of course, the individual investor gets the least information and gets it last. But even within my world, the playing field is not level for institutional investors that aren't as big or as powerful or don't have as many votes in the *I.I.* survey as others, or for those who simply are not able to attend a particular small-group meeting. There are the official rules and then there is the way things really are.

A perfect example took place on June 14, 2001, when I sponsored a private meeting with Global Crossing executives for a small group of seventeen carefully selected clients. As it turned out, a lot of hedge fund guys came to this particular meeting, from such big names as SAC, Pequot, Galleon, and Chilton. Some of them were short Global stock and were loaded for bear, hoping to hear some bad news that would drive the stock down. They wouldn't be disappointed.

The meeting took place at 88 Pine Street, Global Crossing's New York headquarters. It was a very modern space, with lots of black and silver and a sleek new-economy feel to it. The schedule called for an executive from every major sales category of the company to make an informal presentation and take questions from us. But as we got ready for the 2:00 PM meeting to start, I was surprised to see Global Crossing's fourth CEO in three years, Tom Casey, a former banker at Merrill and lawyer to telecom companies, stride into the room with Global's president, David Walsh, by his side. Tom hadn't been on the agenda.

The turnover at the top of Global had been worrisome—the stock traded down every time one of the CEOs left—but at the same time, understandable: each of them was paid such an outrageous amount of money in salary and stock options (Bob Annunziata left with $16 million for 11 months of work) that no one was surprised when they headed off to the beach after a year or so.

Yet later it was learned that Tom Casey's predecessor, the previous CEO, Leo Hindery, convinced that Global Crossing's business was not as strong as everyone believed, had written a devastating memo to Chairman Gary Winnick at the time of his departure nine months earlier, although this wouldn't be discovered by investigators until the

following year. Leo predicted the company would fail unless it made major strategic changes. “Like the resplendently colored salmon going up river to spawn, at the end of our journey our niche too is going to die rather than live and prosper,” he wrote. “…The stock market can be fooled, but not forever, and it is fundamentally insightful and always unforgiving of being mislead [*sic*]….Without looking like we’re shaking our bootie all over the world, [we should] sell ourselves quickly to whichever of the six possible acquirers offers our shareholders the highest value.”[3]

But the booty shaking apparently hadn’t attracted anyone, so here was Casey, standing all alone, his booty still. He wanted to chat with the group before the sales presentations began, so I introduced him quickly and he got right down to business. Casey asked what he said was a “hypothetical” question: “What would you guys think,” he said, “if we stopped selling IRUs and instead sold capacity only via shorter-term leases?”

IRUs, otherwise known as indefeasible rights of use, were long-term rights to use Global’s fiber-optic network—its main asset.*

Tom Casey’s “hypothetical question” immediately raised eyebrows in the room. Most of my seventeen clients had their BlackBerries and, boy, did a lot of thumbs suddenly get a workout. Just about everyone in the room understood in a split second what I did—that Global must really be having problems selling IRUs—and this meant big trouble for the stock. Tom Casey hadn’t said the company was definitely changing its policy, nor had he warned that its forecasts were in jeopardy, but his hypothetical question caused everyone to ask their own question, which was some variant of the following: why would he even consider voluntarily halting the IRU gravy train unless customers were jumping off it?

I immediately asked for more. How would they make this transition, and why would they consider it? Others asked Tom if he was seeing tougher price competition or slower demand, and whether, if Global made this move, it would be a temporary or permanent decision. His answers didn’t satisfy anybody. Everyone who worked for a hedge fund, and therefore was able to sell stock short, instantly sent a note back to their trading desks: “SHORT GX!” In the course of one hour, from 2:00 to 3:00 PM, Global Crossing’s stock dropped 17 percent, from $10.50 to $8.66, on heavy volume, proving once again the insider’s advantage the big guys had over the little guys. Other than those of us in Global Crossing’s conference room, no one knew why the stock was falling—not individual investors, not institutional

investors, not even those watching CNBC and other financial news shows.

At 5:00 PM, Tom Casey and Global's IR director, Ken Simril, moved uptown to another private buy-sider meeting, this one a dinner hosted by Jack Grubman. I rushed back to the office and prepared a report with my team that would cut our forecasts for Global Crossing. It seemed obvious that the buying power was shifting to the customer and thus future revenues would be lower. I left at about 10:00 PM and Ido and Ehud stayed at the office to make changes to the final draft. By the time I got home an hour later, the report was ready to go. Ehud asked if he could run the report by Ken Simril, the IR guy, figuring we'd get more detailed feedback if Ken had to react to something concrete and in writing. I said fine. At around midnight, Ehud and Ido called back to say that Ken had awakened Global's CFO, Dan Cohrs, at the St. Regis Hotel and that he would soon be calling us to talk about it.

As tired as I was, I was happy about this. Cohrs knew the forecasts cold and thus we'd at least get a sense of whether our numbers were lower or higher than theirs. Either way, we'd be smarter after the call. At about 1:00 AM, my home phone rang again. On the line were Ehud and Ido, a very sleepy and annoyed Dan Cohrs, and an equally sleepy but not-yet-annoyed me. The CFO didn't waste any time.

"Dan, do you have to publish this?" he asked in a raspy voice. "I don't see why you have to or why you would want to. It was a private meeting, Tom's comments weren't official, in fact they were hypothetical, and we are not changing our guidance at all. We said similar things at Jack's dinner and Jack had no problem. He will be reiterating his numbers tomorrow morning."

Well, hooray for him, I thought. Had Jack not realized what Tom Casey was saying, or Casey toned down his comments for the dinner, realizing how much they had scared the earlier audience? I had no idea, but I did know that I didn't appreciate Cohrs's attempt to goad me into backing off. Anyone who thought I was going to follow Grubman's lead was smoking some very strong stuff.

"I understand your points and I appreciate them," I said, as I had now learned to at least pretend to be listening before I delivered the news people didn't want to hear. "However, I already had some concerns about my forecasts that were amplified by the discussions today."

Cohrs cut me off. “But, Dan, this creates a big FD [Regulation Fair Disclosure] problem for me. It forces me to make a filing with the SEC tomorrow saying that we have changed our guidance.” I didn’t know if he meant this or not, but, if he did, he was admitting that the company had given material information to one group that it hadn’t shared with everyone—exactly what Reg FD prohibited.

“Hold it right there,” I said. “I don’t know if you have changed guidance or not. But I do know that I’m more concerned about your revenue outlook, and I need to lower my forecasts as a result. These are my forecasts, my points of view, and my concerns. I’m not saying you lowered guidance. We are simply lowering *our* forecasts. I apologize if this puts you in a corner, but I just have to do it.”

Cohrs, quite pissed, signed off. It was now 1:30 AM and we were all exhausted. The next morning, Ehud spoke on my behalf at CSFB’s morning meeting, informing the salespeople that we were lowering our forecast for Global’s 2001 revenues by 8 percent. Our report was published a few minutes later. Cohrs opted not to make a filing with the SEC.

Also that morning, a report from Jack, titled “Global Crossing: *True Feedback* [emphasis added] from Management Meeting” appeared. “Contrary to comments by a competitor,” he wrote, referring to me, “GX management did not alter prev. published financial guidance…. GX did not say it was changing [its] business model to a leased vs IRU business. Pressure on stock overdone. Reiterate buy.”

We were onto something, but I still didn’t downgrade the stock from its Buy, or “2,” rating, because Global was now at $8.66 a share—significantly below my new and lower target price of $14. I concluded it was simply too cheap to bail out now.

A few weeks later, I received a message from Gary Winnick, Global Crossing’s chairman. I called back and his secretary hooked me into his cell phone, as he was en route to investment banker Herb Allen’s exclusive annual powwow of business movers and shakers held every year in Sun Valley, a fact he wasted no time announcing. Although Gary’s tone was polite, his words were biting.

“I heard you are predicting a revenue miss in the second quarter,” he said. “I just want you to know that you will be proven wrong.”

I suppose those were intended to be fighting words, a threat in the sense that I would be embarrassed for lowering my forecasts. But,

with a positive rating still on the stock, I was actually hoping he would be proven right. And, given that the quarter was already over, I figured he—if anyone—should know. Better to be wrong on the forecast but right on the stock, I figured.

Nacchio's Wrath

Just around the time of Gary Winnick's phone call, *The Wall Street Journal* ran a story, "Overbuilt Web: How the Fiber Barons Plunged the Nation into a Telecom Glut."[4] It argued that the race to build out capacity had more to do with the dueling egos of Level 3's Jim Crowe and Qwest's Joe Nacchio than the need for more fiber. Still, Qwest came out as the winner in the piece, mainly because it was well-diversified with its ownership of US West. It was clear that the biggest losers were incumbent long-distance companies such as WorldCom and AT&T, which were in full meltdown. Despite the fiber glut, companies like Global and Qwest were still signing up corporate and government customers for high-speed data and Internet services and hitting their numbers.

Not everyone, however, believed that. Simon Flannery, Morgan Stanley's fairly new telecom analyst, had also been recommending Qwest with an Outperform or "2" rating, Morgan Stanley's equivalent of CSFB's Buy. A serious Irishman with a decent reputation, I didn't know him too well, but had seen some of his reports and they were excellent. On June 20, 2001, he published a report, co-written with two other Morgan Stanley analysts, lowering his rating on Qwest to Hold based on a bunch of arcane accounting concerns.

I studied the report carefully and reviewed each of its arguments. While I believed there were some interesting technical points about the accounting, I also thought these items would not affect future revenues or cash flow, the two elements that most affected my Strong Buy rating. The report also questioned whether Qwest's current rate of revenue growth was sustainable, without showing any real evidence to the contrary. I concluded it was just Flannery's hunch. My analysis of Qwest's recent financial reports showed the opposite.

At a time when most analysts were still bullish on Qwest, Simon's report hit the Street with a bang. And good old Joe Nacchio, as you might imagine, was apoplectic—and determined to make this guy pay. Later that same day, Joe held a conference call to respond to Simon's report. I couldn't remember any other company ever holding a conference call specifically to refute an analyst's report. I thought it would be an interesting call, and I was right.

"I'd like people to make sure they're listening clearly," Joe said. "There are no accounting issues or improprieties in Qwest's financial reports. Let me repeat that. There are no accounting issues or improprieties in our reports. Innuendoes [*sic*] on our integrity are not going to be tolerated," Joe raged, "irregardless [*sic*] of who makes them, including what I used to think was a reputable, branded firm like Morgan Stanley. This report is laced with innuendoes that are unsupported and are a direct attack on our intelligence and our integrity. I'm extraordinarily disappointed with what I consider unprofessional and irresponsible behavior from a major investment bank."[5]

Joe didn't stop there. To an audience of over 1,000 fund managers and analysts, he said he had called Phil Purcell, Morgan Stanley's CEO, and reamed him out. Then he declared that Morgan Stanley would no longer be considered for Qwest's investment banking assignments and cast aspersions on the firm's motivations.

"For a firm like Morgan Stanley to be taking this approach with us, while at the same time they have Strong Buys on companies that have large financings in front of them, would make me look twice," he shouted. Thereafter, Simon was banned from visiting the company or talking to its executives. He also was blocked from asking questions on Qwest's investor calls.[6]

I was hardly surprised to hear this, given what I'd experienced with Nacchio. But I couldn't believe how far he had gone. Intimidation in private was the norm for Joe, but to go public with it not only was outrageously unprofessional but also managed to unify the entire investment community against him. Though many of us disagreed with Simon's conclusions, we all supported his right to his opinion. One friend of mine on the buy-side, who owned lots of Qwest shares, even circulated a letter, to be sent to Nacchio, imploring him to let Wall Street analysts do their jobs. I gladly signed it.

I was torn about what this meant for the stock. On one hand, I had never been a fan of Joe's, and this act certainly seemed like that of a CEO who had lost control. On the other hand, I disagreed with Simon's conclusions. Qwest, now trading at $30, was so cheap that it would be silly for investors to sell out now. I felt that the stock had fallen too far on the news, and that investors would be wise to take advantage of this temporary dip to load up on the shares. It reminded me of the irrational arb spread between Qwest and US West share prices when I was skiing in Vail.

It's worth mentioning here that liking a stock and liking a company are not the same thing. There are very few stocks that are not worth buying at *some* price. Investing is a relative game, and smart investors look for mispriced or misunderstood stocks. Often, the most underpriced stocks are those of companies or managements that have stumbled. Qwest seemed to fit the bill: it looked as if it had been beaten up more because of Joe's big mouth and some insignificant accounting issues than for fundamental business reasons. I felt that this would correct itself over time, as long as Qwest continued to grow its revenues and operating cash flows as it had for the last few quarters.

Although the fiber glut was becoming more and more apparent, Qwest had something the Level 3s of the world didn't—a true blue, nuts-and-bolts local phone company in the form of US West. To me, a longtime fan of the Baby Bell stocks, this was a huge plus and a substantial hedge against the long distance market. So rather than downgrade the stock, I decided to hold firm. I reiterated my Strong Buy, or "1," rating and countered the Morgan Stanley arguments in a conference call that I hosted for buy-side clients. It would prove to be a horrible decision.

The Analyst Plays the Villain

Life as an analyst had always been busy, but suddenly our job seemed a lot more like that of Bill Murray in *Groundhog Day* than anything else: hear bad news, absorb it, lower estimates or ratings, try to quickly interpret it for clients, wash, rinse, repeat. Gone were the deals and the road shows plugging IPOs for the most part, since falling stocks meant most companies had a terrible time raising capital. This meant a lot more time for research and a lot less traveling. It was the one benefit of the downturn.

Yet just when I should have been using my extra time to really dig into the numbers behind all the companies I covered, I simply slowed down. I don't know if I was burned-out or depressed or preoccupied by the carnage around me, but I didn't go the extra yard that might have helped me uncover the numerous frauds. The timing was perfect. I had a great staff with the skills and brains to do it, and a lighter schedule. I should have focused more on the IRU business, which might have led me to uncover the growing number of swaps that were being used to boost revenue numbers. I didn't.

As the market continued to tank, the press, formerly fawning lapdogs, turned into attack dogs. And what these dogs dug up put

everyone in my world on the defensive. The media's story line went like this: every little guy got ripped off, while every big executive or Wall Street insider walked away, pockets bulging with ill-gotten gains. But it was not quite as simple as that. Greed is a very democratic emotion. There were some little guys who picked up their chips and walked away at the right time, just as there were others who bet everything on the pass line and came up craps. There were big shots who truly believed that their companies were changing the world, and others who used their insider connections and information to take advantage of a bubble.

No longer big swinging dicks, geniuses, or industry power brokers, suddenly everyone on Wall Street bore the scent of scandal. The biggest fingers pointed at analysts, who had been lionized as "power brokers" on the way up and now were being made into buffoons on the way down. The guru days were clearly over. What had become celebrity was beginning to become notoriety, and even those of us who had tried to stay on the straight and narrow were beginning to be looked at with scorn. We were crooks, manipulators, swindlers, or—best case—incompetents who never saw it coming.

In some kind of weird karmic boomerang, the biggest winners in the bubble economy quickly became the biggest losers. First to fall had been the Internet analysts, the most famous of whom were Henry Blodget of Merrill Lynch and Mary Meeker of Morgan Stanley. In March of 2001, Henry Blodget's role as analyst-cum-banker was highlighted in a series of articles in *The Wall Street Journal,* and subsequently an investor brought a suit against him, claiming Blodget had recommended stocks that he thought were dogs. Merrill would settle the suit a few months later for $400,000, unleashing a tidal wave of similar lawsuits. In May 2001, *Fortune* ran a cover story, "Can We Ever Trust Wall Street Again?" featuring a very unflattering, sinister-looking picture of Mary Meeker.[7] I didn't know either of them very well. But I thought the accusations were still far from hitting the bull's-eye. After all, Merrill hadn't really been all that successful in the technology banking sphere, and neither of these analysts seemed to have used their insider information and connections to vault themselves to power the way many thought Grubman had.

But Jack quickly became the third Musketeer in this very public hanging. WorldCom's continuing disappointments weren't helping, nor were the seemingly monthly death knells of the startup carriers he'd recommended for so long. Most frustrating for many investors was Jack's refusal to admit he'd been wrong. The anger went beyond the press to his own clients and brokers, who suddenly chomped on the

hand that had fed them. If he had such great inside connections to these companies, they wanted to know, how could he not have known that they were in trouble? I was sure that finally, Jack's dealings were on the verge of being exposed, and I looked forward to that moment.

Suddenly, the regulators and the politicians woke up from their decade-long hibernation with hearty appetites. The damage was already done, but that didn't stop anyone from sounding as if they'd suddenly discovered that the earth did, in fact, revolve around the sun. Led by Louisiana Republican Richard Baker, the House of Representatives announced it would hold hearings on the topic of conflicted research. Arthur Levitt, the chairman of the SEC, had resigned in early 2001. His temporary replacement, acting Chairwoman Laura Unger, announced in June an investigation into conflicts of interest on Wall Street, focusing particularly on analysts' own holdings of stocks they may have recommended. At the end of June, the SEC finally issued an alert to investors identifying what it called "key issues that could compromise the objectivity of the research."[8] There were also rumors that the New York State attorney general, Eliot Spitzer, was launching his own investigation into conflicted research.

In the meantime, the finger-pointing was beginning to affect senior executives at the banks as well. One of the first to take the fall was Allen Wheat, the CEO of CSFB. In December of 2000, *The Wall Street Journal* had reported that the SEC and the U.S. Attorney's Office in Manhattan were investigating the way in which investment banks were doling out IPO shares. The allegations were that CSFB, and possibly other banks, were involved in a kind of kickback scheme, in which some institutions and hedge funds would receive large allocations of shares in hot technology IPOs if they agreed to pay higher-than-normal commissions.

I had heard nothing about the investigation and knew only what I'd read in the papers, but CSFB had opened its own probe into the events—centering on Frank Quattrone's institutional sales group—and by June, three brokers from Quattrone's San Francisco office had been fired. A few weeks later, on July 12, 2001, in a weekend coup, Wheat was unceremoniously canned by his Credit Suisse bosses in Zurich. His replacement was none other than "Mack the Knife," John Mack.

John had resigned from Morgan Stanley earlier in 2001 after Morgan Stanley merged with Dean Witter and he lost the battle with Phil Purcell for the top job. The intracompany battle would keep raging for many years after Mack left, and would culminate in a

virtual civil war between Dean Witter and Morgan Stanley factions that led to Purcell's resignation and Mack's reinstatement in 2005.

With Mack's reputation for cutting costs, it was clear that there would be many changes and probably a lot of layoffs. Many expected Mack to reduce the power of Frank Quattrone's technology group. Poor Wheat, I thought. What a naïve guy. He had delegated too much and paid the price. But I was happy to see John Mack again. It had been six years since he tried to entice me back to Morgan Stanley. I hoped he'd clean up the place fast and work to get the regulators off the firm's back.

But the first thing John Mack did gave all of us in research a little bit of pause. Right around the time that he took over, Mark Kastan downgraded McLeodUSA, a startup local carrier that was buckling under the weight of the enormous debt it had taken on. Mark didn't tell the CSFB bankers or anyone at McLeod before doing so, of course. It turned out that the top guys at Forstmann Little, a giant buyout firm that had invested $600 million in McLeod, were furious about not being alerted and complained to John Mack.

So within weeks of getting there, Mack's research department promulgated a new and very scary rule: all analysts had to give advance notice to both the relevant banker and the company when they were planning a downgrade. I supposed the idea was to give the banker a chance to call the CEO and soften the blow, but Mack's rule put even more fear into the hearts of CSFB's analysts. It seemed to give the bankers and company management yet another opportunity to pressure us either by giving the banker and company one last chance to argue with the analyst or by discouraging downgrades altogether. I found Mack's move particularly strange at a time when the SEC and Congress were finally bringing the symbiosis between bankers and analysts under the microscope.

Changes were underway at other banks as well, but in the other direction. On July 10, Merrill prohibited its analysts from owning or buying shares in companies they cover. The previous month, it had started disclosing on the front page of its research reports whether the firm had or might have investment banking relationships with the companies its analysts were covering. (The former had always been disclosed in fine print at the end of its reports; the latter was a new disclosure.)

I figured this move couldn't hurt, but it didn't address the crux of

the research-banking conflict, which in my view was that some analysts were writing opinions they didn't believe, and some were using over-the-Wall information improperly. I had always avoided trading in stocks that I covered anyway, because I knew that occasionally I would go over the Wall and receive nonpublic information. What if, a day before an acquisition was announced, I unwittingly bought shares of the acquiree? It would look as if I was profiting from advance knowledge.

Jack, the All-Knowing

You would think that by this time Jack might have toned it down a bit. But just like the feisty boxer he claimed to be, when pushed into a corner Jack didn't cover up but instead came out swinging even harder, trying to remind people that he still ruled the roost and knew more about what was going on than anyone else. He loudly and frequently repeated his bullish views on his long list of favorite stocks, as if they were neglected children who needed his unconditional love in order to grow. Earlier that year, he had come out with a report he titled "Grubman's State of the Union: Does He Ever Stop Talking?," a massive tome on the telecom industry whose title might have seemed merely arrogant in his glory days but now sounded completely detached from reality.

In Jack's conference call to discuss the report, held on March 15, 2001, he had first made sure to point out that there were over 500 people listening in. "Over the next 12 to 18 months," Jack concluded, "which seems like an eternity…you will probably look back on some of the prices today and say gee, I wish I had loaded up…[on startup telecom stocks]." Jack was increasingly on the defensive, and since it was *I.I.* voting season, I didn't mind a bit. I wasn't looking too hot either, with my disastrous Strong Buy, or "1," rating on Qwest and a Buy, or "2," on Global Crossing, but I was getting accolades from clients for my cautious call on WorldCom and my long-held view that incumbent long-distance stocks were losers and the Baby Bells were winners. With the local startup collapse, the Bells were looking even better, since they would likely face less competition and lose less market share.

On July 24, about 30 cable and telecom sell-side analysts showed up at the Four Seasons Hotel in New York for a private dinner hosted by AT&T. About two weeks earlier, Comcast, the large Philadelphia-based cable television company, had made a $44.5 billion bid for the cable TV properties that AT&T had acquired with much fanfare over

the previous few years, and we were there to hear more.

One very large conference table was set up for dinner. Each of us was assigned a seat next to a specific AT&T executive. I sat next to Mike Armstrong, AT&T's CEO, while Jack sat across from us, next to Armstrong's CFO, Chuck Noski. Although Armstrong had already said publicly that Comcast's bid was too low, many investors and telecom specialists believed that it was a good offer and that AT&T was simply bluffing and would ultimately accept it. I remained restricted on AT&T shares because CSFB was the banker for its three-way split-up. So, unlike most of the analysts in the room, I couldn't make predictions or issue an opinion.

After Armstrong and Noski had finished their prepared comments, it was time for Q&A, and Jack was one of the first to speak up. He brought up the Comcast bid. "You know, uh, frankly," the eternal know-it-all blustered, "when I was talking with one of your board members the other day, it was clear you have no intention of accepting the current Comcast bid."

The room hushed. We all swallowed whatever we had in our mouths (dessert, I think), and my jaw grew slack. Had someone slipped a mickey into my mousse? Had Jack Grubman just publicly declared that an AT&T board member, perhaps his boss, Citigroup's CEO, Sandy Weill (that's who immediately came to mind), was telling him what was going on inside AT&T's board meetings?

"Did he really say that?" I whispered to the analyst next to me, shocked at Jack's recklessness. "Amazing what that guy gets away with," he responded.

AT&T's board had already announced that it wasn't interested in Comcast's initial bid, so the information wasn't officially insider information. But what Jack was doing—not in front of clients this time, but in front of competitors and executives, the oddest of all audiences, since this didn't help him win business or impress investors—was announcing that he was privy to what was supposed to be the most private forum a company could have. Jack was saying he knew something only the board could know—that it was not bluffing and that it had no intention of accepting that bid even if Comcast refused to up its offer. He was also insinuating that his source would tell him what was happening as the negotiations with Comcast—or any other bidder—unfolded.

If Jack had indeed had this conversation, it was dangerous, since

he risked getting his source in big trouble for leaking confidential board deliberations, and it was stupid. But he simply couldn't help himself, I guessed. His seemingly pathological need to impress got in the way of his instinct for self-preservation. I turned to see what Armstrong was doing, but he had turned his face away and sat silent as a stone. In the end, Comcast did up its bid and AT&T took it.

Qwest and Global: The Swapstakes

In the beginning of August, Gary Winnick broke his promise: Global Crossing missed its second-quarter 2001 numbers. With the stock now at $7 per share, I immediately downgraded the stock from Buy to Hold, or from "2" to "3," certain, finally, that this company was in big trouble.

It was apparent that Gary had no clue how bad things were, even very late in the quarter. That was almost as troubling as the disappointing numbers, because it meant he was either incompetent or completely out of the loop. Neither explanation was very comforting.

Even more disturbing was the fact that the company was using what it called "reciprocal purchase agreements" to generate more than one-fifth of its revenues. These agreements, also referred to commonly as "swaps," were the ultimate addiction of many of the companies that flamed out so spectacularly in 2001 and 2002. Basically, a swap was an agreement by two companies to purchase goods or services from each other at the same time, inflating both companies' revenues without any true economic purpose being fulfilled. In the case of Global Crossing or Qwest, the company would sell another phone company the right to use its fiber, as these companies did with the IRUs, and at the same time purchase the rights to use some of the other phone company's capacity. If done for legitimate business reasons and at market rates, there was nothing wrong with a swap. But if done to create the illusion of business that didn't really exist or if priced at above-market levels, swaps were inappropriate at best and illegal at worst. Either way, if not disclosed to investors, they were very misleading because they suggested that revenues were higher and growing faster than they really were.

For example, Qwest might purchase an IRU from Global Crossing giving it the right to use the latter's New York to Houston fiber-optic line, while Global purchased rights to use Qwest's Los Angeles to Seattle line. The two companies might agree to pay each other $100 million. It was reasonable to think each company was filling in geographic holes, but you couldn't really be sure. Each would then

book the $100 million received as revenues in “year one,” while spreading out the $100 million paid over the 20 or so years it expected to use that fiber-optic line.

The net effect: each company had juiced its revenues by $100 million and its operating cash flow by some large fraction of that. Both companies could therefore proclaim a lot of new business and meet their revenue goals even though it wasn’t clear if this was a real transaction or just a mutual backscratching exercise. Most companies didn’t report the results in enough detail to know for sure. Some, including Qwest, didn’t even tell us they were doing swaps at all.

Global Crossing, to its credit, had first mentioned its swaps in May of 2001 when it reported its first-quarter results. But the mention was buried in one vague sentence in a long press release full of self-congratulatory quotes from Global Crossing executives. As far as I know, no one—including me—took any note of it, which isn’t surprising considering the company had exceeded most analysts’ expectations for revenues and cash flow. And the market didn’t notice either: Global’s stock rose 30 cents to $14.10 the day after the swaps were reported.

By the second quarter, however, it became clear that swaps were making up a good deal of Global’s revenue growth. It wasn’t certain there was anything wrong with the accounting—Andersen, Global’s accountant, had apparently okayed the approach—but it seemed odd to me and many of my clients that so much of its new revenue was coming from these seeming quid pro quos. Swaps became the topic de jour; we all began to ask every company we covered how much of its revenues, if any, came from swaps and how it was accounting for them. It wasn’t until near the end of the year that Qwest publicly disclosed its swap revenues.

On August 6, a few days after Global missed its numbers, Gary Winnick called me again. I called back and was patched through to him at his new home in Beverly Hills, where I could hear the sounds of hammers and power saws. Gary’s new home was not just any old new home: this palace, formerly owned by Conrad Hilton, had at least a dozen bedrooms and a dozen bathrooms. Gary had paid some $60 million for the Bel Air estate, making it, at the time, the largest sum ever paid for a private home.

Global Crossing, although it had never made a dime in profit, had just two years before boasted a market capitalization greater than that of General Motors. And Gary Winnick, unlike some of his competitors,

had sold a portion of his shares while the stock was still high, netting an astonishing take of over $700 million. Now the stock was trading at $6.28 per share. Either he was a damn smart investor, understanding that his new company's shares were propelled by an unsustainable bull market, or he knew something the rest of the world didn't about Global's problems.

To be polite, I asked him how the renovations were going. "Good," he said. "It's a big project [and indeed it was, costing something like another $30 million], but it's coming along nicely." Pleasantries over, Gary got down to business. He acknowledged that he'd been wrong when he assured me second-quarter revenues would come in on target.

"Dan, I know we didn't make the numbers," he said. "You know, I have been leaving Tom [Casey] alone and thought he could handle it. But I'm gonna get back involved now, as I want to make sure we get back on track."

"Oh, okay," I said, not sure what else to say.

"Gotta go," Gary said, over the din of pounding hammers and static from the cordless phone. "Someone's at the door."

Get back involved? From my perspective, he'd always been part of day-to-day management, or if he hadn't been, why hadn't he? Yes, he was the nonexecutive chairman of the company, but he was also its founder and had billions still riding on it. I thanked Gary for the call. At least he was man enough to acknowledge how wrong—or misleading—he'd been. I didn't know which it was, but neither was good. No top executive had ever given me assurances that were missed so widely. And no top executive had ever admitted to me he was not sufficiently involved in his business.

Vindicated—But So What?

On September 10, 2001, Qwest reduced its earnings guidance for the first time. Joe Nacchio was finally admitting that Qwest wasn't necessarily going to be the ultimate Survivor and was not immune to the problems affecting everyone in our industry. He refused, however, to admit that there was anything funny going on with the numbers.

"There is no accounting issue," Joe said in a conference call that day. "Let me say this one hundred percent clear." Referring to Morgan Stanley, he continued, "There is one house on Wall Street that doesn't

understand…. We follow the rules."

Qwest's guide-down was big, and bad, news. But just as I was trying to decide whether this signified the end of this company's run as a growth stock, the terror attacks of September 11 made this huge shift in the telecom business seem irrelevant and unimportant.

On that Tuesday, Paula and I were in Italy, partway through a bicycling trip in Parma. I had been trying to call in to my voice mail as we pedaled along (this time I'd brought a cell phone), but AT&T's international circuits were constantly busy. We walked into the lobby of our hotel, sore from biking 30 miles, and saw a group of people huddled around the television. We assumed it was a soccer match from the emotional intensity of the crowd. But it wasn't.

We glimpsed the screen with the pictures of the falling towers and stopped in shock, unable to move or speak. It was the most terrifying image I have ever seen in my life. We held each other, horrified, thinking of all the people we knew—and didn't—that might not have made it out alive. We frantically tried to call home to check on friends and family, but we couldn't get a circuit to the States. Fortunately, the hotel concierge let us use her computer, and using e-mail, we learned that our kids, our kids' friends' parents, and our niece and her boyfriend, who lived just a little bit north of Ground Zero, were okay. CSFB's offices, located in lower Midtown, were not at Ground Zero but were not too far from the carnage.

I finally managed to get through to my office and spoke to everyone on my team, urging them all to just go home to be with their families. But many thousands of people, some of whom were family members of people I worked with, were not okay. After years of nonstop work, I realized in a split second—as, I'm sure, most people did—that our obsessions with work and careers were meaningless in the face of such tragedy. All of these years of analyzing, picking stocks, competing: did any of it really matter?

On Wall Street, the attacks simply froze every assumption and every thought process in its tracks. They may also have halted many of the investigations into these companies or individuals in their tracks, partly because the SEC's Wall Street investigation office—with all of its documentation and casework, including that Grubman file that had ostensibly been started years earlier—was located in one of the World Trade Center buildings. Its findings simply dissolved into dust like everything else.

Yet Wall Street, animal that it is, never grinds to a halt for too long. So even though it wasn't known when the markets would reopen, we were told to be ready to make a call on our sector and stocks. Would they be helped or hurt by what had just happened?

On Monday, September 18, when the markets finally reopened, Paula and I were still in Europe, since we couldn't get a flight home. We were driving from Milan to Paris, since Paris had far more U.S.-bound flights. I used my cell phone to call in some comments about how phone companies, particularly Baby Bells, do well in uncertain times and tend to be countercyclical, but I was deflated and depressed, as was everyone. It all seemed so pointless. Whether or not WorldCom or any other company made its numbers seemed so irrelevant.

In reality, the tragedy of September 11 provided convenient cover for many of the struggling telcos—as well as many other companies. The uncertainty it brought on froze the purchase and expansion plans of many of them. If M&A had been drying up before, it was now as parched as a desert. Any earnings disappointments or misfires that came up could now be laid at the feet of the global disruption rather than any flaw in a company's business model or execution.

Right in this midst of the chaos, the news I'd been waiting to hear for so long finally arrived. After four long years, I had finally regained the number one position in the *Institutional Investor* ranking of research analysts in the wireline telecom category, because my picks, the Baby Bells, had held up relatively well compared to WorldCom and some of Jack's other favorites. Jack was second, though still tops in the startup local carrier sector, not that there were many companies left in it.

In May 2001, when clients had voted, what they knew was that the incumbent long-distance companies, especially WorldCom, Jack's favorite, had crashed, while the Baby Bells were looking like the survivors, to use Joe Nacchio's word. Jack had done such a great job of being identified with WorldCom's success that he was now twinned with its failure. He began to look like the Wizard of Oz—a lonely, powerless man behind a flimsy curtain—rather than the all-powerful, all-knowing, larger-than-life magician so many believed he had been.

In a normal year, I would have been thrilled, proud, victorious. Now, in the context of a terrifying new world and a dying industry, it didn't feel like much of a victory. I had achieved the professional goal I'd worked toward for many years. Sure, the number one ranking on the *Institutional Investor* magazine poll made my team and me feel

happy, relieved, even vindicated, but there wasn't any partying or cheering.

Our team was evolving, too; Ehud—who I had hoped would soon take over the bulk of my coverage of stocks—left to work at a hedge fund. And Ido, Julia, and Connie understood that one of my primary motivations for keeping going for so long—to beat my chief rival—was no longer there. I'm sure they wondered whether I would quit soon.

For me, the victory couldn't help but feel hollow. When I arrived home and told Paula the news, she congratulated me, but it didn't take long for her to ask, "So what's going to keep you going now?" It was a good question. The twin towers were down, the markets were down, much of the telecom industry was down, the reputation of analysts was down, and even Jack Grubman was on the way down. Every part of my professional world was unraveling, from the companies I followed to the firms I worked for. I still felt good about the way I'd done my job, but I didn't feel good about doing it in an environment like this one. As we talked, it was clear that I'd lost my passion for the business.

There was one moment of personal satisfaction, however, and it happened in late September, when *Institutional Investor* scheduled a photo shoot for all the top-ranked analysts at a studio on the far west side of Manhattan. I walked in to see about 50 analysts, most of whom I didn't know. Someone called my name and I looked up to see an old colleague from Merrill.

Standing next to him was Jack, who was still ranked first in the local startup category, although I had recaptured what was called the telecom or "wireline" slot. When he saw me, his jaw dropped and his face went gray. Even with the dramatic fall of WorldCom's stock, his reversals on AT&T, and the virtual demise of most of his favorite startup local phone companies, it seemed it had never crossed his mind that he wasn't still the king of the telecom hill. Until that moment, he clearly had no idea that he had lost in the wireline category. Doing what I thought was the right thing, I stuck out my hand to "congratulate" him. He muttered something incomprehensible and turned away, clearly mortified that not only had he been unseated, he'd had to learn about it in front of all his peers.

Outed: Qwest's Accounting Gimmicks

Almost immediately, more bad news set in. On September 27, the next-to-last trading day of the quarter, I got a phone call from Rob Gensler, my client at T. Rowe Price, a large mutual fund company. Rob headed up T. Rowe's Telecom/Media fund and also served as T. Rowe's in-house telecom analyst. He was the most aggressive person I ever encountered on the buy-side. He had a memory and quickness with numbers that was unbelievable, and he was better at wheedling information out of people than anyone else in the business.

Rob had quite a colorful résumé: he had both worked at Salomon's infamous arbitrage desk for several years and taught in the Peace Corps in Botswana. He lived in Baltimore and traveled virtually nonstop all over the world to visit companies. He relentlessly worked the phones to keep up on what company executives were saying and influential analysts were thinking. He also tried to influence sell-side analysts' opinions, because that might help his picks do better.

Calls with Rob were usually long ones, full of energetic debate. Generally we had covered every company in the industry by the time we were through, and I always felt that I'd learned more from him than he from me. So when I got his message around noon, I didn't call back right away, because I knew it would require some quality time. Instead, I called back after the markets had closed. Qwest shares had fallen precipitously, about 15 percent, that afternoon, so I fully expected this would be a key discussion point with Rob. And it was.

"Dan, I've already told six of your competitors this," Rob started off. Damn, I should have called back earlier.

"It looks like Qwest is doing some funky deals to gin up revenues for the quarter. They are selling equipment at big markups to a company called Calpoint [he said 'Calpoint,' but I thought I heard 'Calport'] that, in turn, is going to establish an Internet and data transport company. Calpoint needs to raise $600 million to buy the equipment, and Qwest is guaranteeing its debt. It's a joke and it looks like it is being used to bulk up third-quarter revenues."

"How Do You Know This?"

It turned out that Calpoint had circulated some financial documents to the unit of T. Rowe Price that invested in bonds and other debt instruments. Apparently, this Calpoint company—which neither Rob nor I had ever heard of—was trying to borrow money from large investment firms, hedge funds, and pools of private money. Only a

select group of professional money managers hear about these kinds of investments, referred to as *private placements.*

Rob was basically saying that Calpoint was "buying" Qwest's equipment, which Qwest could then book as revenues, in return for Qwest's guaranteeing its debt. In other words, Calpoint was essentially a shell company, backed by Qwest. Sure, it was promising to buy equipment from Qwest, but those purchases would be funded with borrowings backed by…Qwest! Oh, shit, I thought, Joe Nacchio wouldn't manufacture revenues that wouldn't exist without the shell company, would he?

"Rob," I said nervously, "I can't believe that Joe would book this stuff as regular recurring revenues. That would be preposterous. This sounds like it is simply a financing transaction like the ones we used to do at MCI back in the 1980s. We never even considered booking the proceeds as revenues. There's no way Qwest could put that over on their accountants!"

"I've called Lee Wolfe [Qwest's IR guy] for the past three days," Rob said, "and told him I need to know how this is going to be accounted for. But he hasn't called back. Why don't you call him or even try Joe and see what you can get?"

I agreed, then hung up and left a voice mail for Lee. "I need to talk to you and Joe immediately," I said. "This Calport [*sic*] thing, or whatever it is called, is spooking many of your holders. I need to have a coherent answer on how it will be accounted for."

At around 10:30 that night, Lee and Joe called me at home. Joe, effusive as ever, told me that no decisions had been made yet on the accounting for Calpoint and that it would be a few days until they had fully determined which deals were complete and thus booked in the third quarter and which weren't. That scared me, so I asked him a more basic question: "How do you feel about making your revenue target for the quarter?"

"Oh, we're gonna be right on target," he said, selling as always. "We just can't comment on a deal-specific basis yet. At the end of any quarter, there are all kinds of balls in the air, and I can't tell you which ones will land in this quarter and which ones in the next."

It seemed to me that Joe wanted the flexibility to book the Calpoint revenues in the current quarter if some other deals didn't come through. He also wanted to be able to hold it over until the

fourth quarter in case it was needed to cover any shortfall then. Like a broken record, he kept coming back to that message: “We are on target. We have no reason to alter any guidance we have given in the past. The third quarter looks real good.”

It was late, I was exhausted as usual, and I was getting frustrated.

“Look, Joe, I think it is important that you fully disclose this deal and that, if it is what I think it is, you make sure to identify it separately from your regular revenues. At least that way, investors will be able to deduct it from their revenue models, as I plan to do. If you don’t call it out separately, investors will think the worst, which is that perhaps you have other undisclosed nonrecurring revenues too.” I had no idea how close I was to catching on to Qwest’s game of boosting revenues with swaps and one-time equipment sales.

Joe hemmed and hawed, but promised nothing. As worried as I was, I didn’t consider a downgrade, primarily because the stock had already dropped 15 percent on this news and I had no idea how Calpoint was going to be booked. This might turn out to be a false alarm. If Qwest did do the right thing or if these concerns turned out to be exaggerated, its shares would surely rebound and it would have been exactly the wrong time to downgrade. In retrospect, to my detriment and the detriment of anyone who followed my advice, I had focused too much on the cheapness of the stock and not enough on trying to figure out whether or not Qwest was playing fast and loose with the numbers.

I assume Rob Gensler and his colleagues at T. Rowe Price avoided a big loss by selling their Qwest shares before he called the analysts. Qwest shares dropped nearly 20 percent, from $19.40 to $15.60, in just five days. There was nothing illegal about this: Gensler was being rewarded for being astute and for reading all the documents available to him—in this case, the private but entirely legal Calpoint prospectus. If he’d been at a hedge fund, he would have been able to go one step further, not only selling his Qwest shares but shorting them, too, for a much larger profit.

This time, the group that was most in the dark was the Street analysts. There was no way we would have seen that Calpoint private-placement prospectus—since it was confidential and distributed only to a small group of potential investors—without connections on the buy-side like Rob. Even the pros got knocked out of this insider game sometimes. We still knew more than the little guys did. But often it wasn’t enough.

Thirty days later, on October 31, 2001, Qwest reported its third-quarter results very early in the morning and held its usual conference call for the investment community. The press release crossed the wires and the results were very disappointing. Revenues were flat, almost $100 million shy of my forecast, and operating cash flow had fallen more than 5 percent over the same period. Even the US West side of the company looked bad, with local revenues up only 1 percent, significantly below my 5 percent forecast and worse than the other Baby Bells.

I got the information while I was uptown at Columbia University, where I had agreed to speak to a business school class. I was shocked. Just as had Gary Winnick, Joe had been wrong, or lied, or something. I urgently needed to lower my forecasts, target price, and, I decided, my rating too. I had been very wrong about Qwest shares. Its torch suddenly seemed to be flickering.

So, as the 9:00 AM Qwest conference call was approaching, I called Ido and Julia, who hooked me into CSFB's squawk box system. I stoically told CSFB salespeople around the globe that there were too many uncertainties lining up and that I simply could not recommend the stock as a Strong Buy anymore. I downgraded the stock to a Buy, or "2," rating, down one notch.

Looking back, I can see my decision to drop Qwest's rating only one level was a huge mistake: much too little, much too late. Qwest shares would fall 24 percent or $4.05, to $12.95 per share, by the end of trading that day, down from an all-time high of $64 and $48.62 a year ago. I had prided myself on my hard-nosed analysis, but that perspective had caused me to miss the forest once again. Part of me saw trouble; the other part of me, the value investor, saw a company that still had a lot of valuable assets and was cheap as hell. My gut told me one thing and my brain another. I went with my brain. It was a low point in my career.

As soon as I hung up, Ido and Julia pointed out that I'd just violated John Mack's new rule that analysts were supposed to inform the bankers as well as the company before they issued a downgrade. I guess I'd blocked out the rule because I didn't like it. So as I signed on for the Qwest conference call, I hurriedly left a voice mail message for Lee Wolfe at Qwest informing him of the downgrade, as well as for the CSFB banker assigned to the company. But the Qwest call was already beginning, so there was no way Lee could have heard the message before the call began.

Joe Nacchio and Robin Szeliga, the CFO, were the speakers. Joe spun the story as always. He admitted that the economic effects of the September 11 terror attacks were hurting Qwest's performance, but proclaimed that everything else was moving along nicely. After their opening remarks, they opened the call to questions. I was the second questioner, and politely asked Robin if she could tell me what the profit margins were on the Calpoint deal.

Despite my warnings, they had indeed included Calpoint in their financials. They had, however, fully broken out its revenue impact, so analysts like me who didn't want to count it as recurring revenue had enough information to remove it from their models. I also wanted to deduct it from the quarter's reported cash flow, and to do so, I needed to know how much profit came from Calpoint or any other swaps. The margin number would solve that puzzle and I assumed it was on the tips of Joe's and Robin's tongues, since they had to know this would be a big topic on the call.

Instead, they stonewalled.

"You know, I don't have that in front of me," Robin said.

Joe butted in, making it clear to Robin that he didn't want her to say more: "Call us after the call. We'll dig up whatever numbers you're looking for."

I tried again. "Let me go back to this margin question," I said. "I mean, you know the margin. I know it fluctuates with contract and with customer and quarter to quarter, but I'd like to understand what it was a year ago and what it is now."

"Dan, call us after the call," Joe said, irritated. "We don't know that answer right now. We're not trying to not tell you. We're trying to give you the accurate information."

I was getting more and more frustrated. I was harried, having missed some of the opening remarks while making those Mack-rule calls, and I fretted that I had missed some key information. My BlackBerry wasn't getting a signal at Columbia, either, so I was cut off from whatever stories were hitting the newswires, including how much Qwest shares were falling.

Robin tried to speak again, but was quickly cut off by Joe. "If you want to know about that specific contract," she managed to say, "we'll dig up the numbers and we'll tell you what it was."

After a bit more of this, I had had it. The low-key, analytical guy I knew so well disappeared. I lost control.

"What are we hiding here?" I yelled.

"We're hiding nothing here, Dan," Joe replied after a brief pause, his voice dripping with condescension. "Let me answer," he snapped at Robin, who had just begun to speak. "Dan, we have local equipment sales like every other [Baby Bell]. The margins are the same. We will tell you what they are when we go back and look at that third-quarter sale. We don't know that right at this moment. There's *nothing being hidden.* If you want to write a note about it so everyone else knows, that's fine. Call us after the call."

Knowing that was all he was going to say, I moved on to another question. That day, Qwest's trading volume surged to seven times the previous day's level. The sell-off continued the next day, with Qwest falling another 95 cents.

Julia and Ido told me afterward that they were amazed. Yes, I had had some rough Q&As over the years, but it had never gone this far. At first, I was embarrassed and thought those listening to the call would think I'd been unprofessional. But it turned out to be the opposite. Even people who didn't know about the downgrade suddenly knew that one of Qwest's major supporters was challenging Nacchio, and they applauded the move.

I thought back to Simon Flannery's report. His accounting points had been a bit off, but his instincts about revenue shortfalls had been spot-on. Qwest's revenues and revenue growth rate, just as we later learned about so many other telecom companies, were inflated by swaps and one-time equipment sales that, in reality, were nothing other than schemes to cover up revenue shortfalls. Qwest was playing fast and loose with the accounting rules and inflating its revenues and cash flow in ways that were misleading and unsustainable.

The next day, I got a call from the senior CSFB banker handling Qwest. He said he'd been speaking to someone at Qwest who had been in the room with Joe Nacchio during the conference call, and he related what he thought was a pretty funny behind-the-scenes story. During the conference call, when I asked them what they were hiding, one of the executives in the room reportedly whispered (with the microphones on mute, of course), "What an asshole!"

Joe, who was still unaware that I'd downgraded the stock, smiled.

“Yes,” he quipped, “but he’s our asshole.”

Not anymore, I wasn’t.

* With a 20-year IRU, for example, Global would sell to a telecom company such as Deutsche Telekom or to a corporation such as Exxon-Mobil the right to use a certain amount of its capacity for 20 years. The payment by DT or Exxon-Mobil would be made up front at a discount. Global Crossing, Qwest, and many other telecom companies sold a lot of IRUs, and it made their numbers look terrific as well. In certain circumstances, if a customer paid 100% up front, a company could book the entire payment as revenue in the first year instead of having to spread it out evenly over 20 years. With the explosion in demand for communications, pricing had been fantastic for IRUs and customers were happy to pay up front for them. But as demand began to slow, it wasn’t certain that customers would still pay in advance rather than stretching out payments into cheaper multiyear leases. If prices were falling, why buy 20 years of capacity today, at today’s rates, if you could buy it cheaper later?

10. Jack Fell Down

2002–april 2003

I watched the decline of my industry and the collapse of the reputations of some of my competitors and colleagues with a jumble of bewilderment, frustration, mortification, schadenfreude, and, perhaps most significant, relief that I wasn't going to be dragged into this mess. At least, that's what I was hoping. But on September 30, 2002, when I got a call from a CSFB attorney named Jennifer Huffman, I couldn't help but feel my heart sink.

The Worm Turns

IT WAS A NEW YEAR, all right, but champagne toasts were few and far between in my world. All of 2001's problems seemed to be snowballing into even bigger ones, with no end in sight to the carnage in our industry—or to the investigations, which kept revealing yet more incriminating information.

On January 22, 2002, CSFB announced that it was settling the SEC's and the NASD's charges of doling out IPO shares to funds willing to pay inflated commissions. The fine was $100 million, the fifth-largest regulatory settlement in the history of Wall Street.

"The profit-sharing activity was pervasive at CSFB," the SEC proclaimed, blaming "senior executives" without naming names. This particular scandal had nothing to do with research, fortunately, but it was yet another stain on the reputation of my firm and Wall Street at large. I had a feeling that this wasn't the last of the checks Wall Street was going to write, but still, as huge a number as it was, it was little more than a swat on the hand by the regulators. After all, $100 million was what one CSFB banker—Frank Quattrone—had made in one year.

Less than a week later, on January 28, 2002, Global Crossing declared bankruptcy, wiping out a market value of $54 billion at its

peak just two years earlier. It wasn't a complete surprise to me or to anyone by this point—the stock had been trading for pennies and its enormous $10 billion debt load was clearly not going to be serviced—but it was sad nonetheless.

Sad for investors, of course, since any of them who got in after 2000 lost their shirts, while Gary Winnick and his rotating band of CEOs sold stock worth in the hundreds of millions. Gary alone cashed in over $700 million over the course of four years, second only to Phil Anschutz—who pocketed $1.9 billion on Qwest—as the industry's champion roulette player.[1] But the bankruptcy filing was particularly tragic in that the promise of this new world had been exposed as nothing more than hype. And even those of us who had questioned the hype had not questioned it enough. It was this century's equivalent of the railroad industry boom and bust in the late 1880s. Customers might use all of those undersea cables one day. But not anytime soon.

Global's collapse came in the shadow of Enron's sudden meltdown the previous December, which had taken the entire financial world by surprise—the auditors, the regulators, and the Street. Now everyone was scrambling to figure out who had left the barn door open and how. Suddenly, swaps, which had been used by many of the companies in trouble, became public enemy number one. Both the FBI and the SEC opened probes into Global's numbers. It wasn't going to help recoup that $54 billion, though. I was pretty sure of that.

It was pathetic—both to watch and to be a part of. At the beginning of March 2002, I held CSFB's annual telecom conference, this time in Orlando at the Portofino Bay Hotel. Rather than meeting at the heart of the financial world, we instead opted for distraction, taking everyone to Universal's Islands of Adventure. One night, we reserved the Marvel Super Hero Island for the exclusive use of conference attendees. Maybe, we hoped, one of those superheroes would save us from the wreckage of our industry.

As I strapped myself into the Incredible Hulk Roller Coaster, I couldn't help thinking that I preferred the real thing to the *virtual* roller coaster we'd all been riding for the past few years. In a real roller coaster, there was gravity; what went up came back down, and we ended the ride where we'd started. On the telecom roller coaster, we'd kept climbing further than anyone believed possible—and then we'd plummeted headlong into a chasm.

Still, as tame as the Universal ride seemed in comparison, it was treacherous in its own way. Megan Kulick, my former associate, who had left Merrill to work for a hedge fund and was now a client of mine, was there. She rode the coaster so many times that she ended up puking her guts out. If that wasn't a sign of the times, I didn't know what was.

Although the $1.1 million budget was less than half the prior year's, we didn't skimp on the goodies. In fact, considering what was going on in the sector, it's amazing how luxe the event was. We were a Wall Street investment bank, after all. We hired Kevin Zraly, the internationally acclaimed wine writer and founder of the Windows on the World Wine School, to host a special wine tasting one evening.

The mood was shell-shocked, resigned, and frustrated. That is, except for the value investors, who, like vultures, picked through the skimpy meat left on the bones of some of these companies and debated whether there was anything worth keeping.

The next week, on March 11, WorldCom announced that the SEC had opened an investigation into its accounting practices. This was not exactly a shock, given that every poster child for the go-go 1990s had crashed, many were under suspicion for aggressive accounting, and WorldCom's stock was now trading at $9 a share, an astounding drop from its high of $64.50. My rating remained Hold, as it had been for the past year and a half.

In a highly unusual move, WorldCom not only publicized the investigation; it also published it in full on its Web site, listing all 24 of the SEC's queries. The SEC request sought information regarding virtually every element of the way WorldCom recognized revenue and detailed information about how it accounted for its merger reserves. It also asked for material explaining how information was provided to Wall Street analysts and how analyst forecasts were tracked. To me, this last one suggested the inquiry was leading straight to that cozy relationship between the company and Jack Grubman. Could this finally be it?

The investigators also asked a lot of questions about an enormous loan of nearly $400 million that the company had made to Bernie Ebbers. By this point, we all believed that Bernie hadn't sold any shares of WorldCom stock, instead opting to use it as collateral to buy other assets ranging from a timber company to one of the largest ranches in Canada. As WorldCom's stock declined in 2000 and 2001, Bernie had faced margin calls from Bank of America, which had

loaned him money against his then-valuable stock and now, as the stock declined even further, required more collateral.

Basically, Bernie was a very rich man—but only on paper. He'd bet every last chip on WorldCom, unlike Gary Winnick, Phil Anschutz, Joe Nacchio, and many other telecom executives, who sold when times were good. I was shocked, however, to learn that the board had apparently approved lending him such vast sums of money and that, in addition to the other banks, Citigroup, the parent company of Salomon Smith Barney, had facilitated this obscene leveraging of his assets much earlier, beginning back in 1999.[2]

At that time, WorldCom's board had faced two very unpalatable choices: one, let Bernie sell massive amounts of stock into the open market, which most definitely would push the stock down further and convince the doubters that even Bernie had lost faith; or two, bail him out. So the board did exactly that. It paid off his Bank of America loan and replaced it with a nearly $400 million loan from the company.

Such corporate "generosity" was highly unprecedented. I had heard about some of the smaller loans in early 2001, but by the beginning of 2002, when the news broke that he was actually $400 million in the hole, I realized how deathly serious the situation was. The guy had been averaging over $12 million a year in salary and bonus and owned, at WorldCom's peak, stock worth over $1.4 billion. Wasn't it just two years ago that he'd exhorted everyone at my conference to play *Who Wants to Be a Millionaire* by buying his stock?

I also was taken aback by Bernie's apparent stupidity. Rather than selling some shares and diversifying his holdings, he had doubled up, and more, on his WorldCom bet. This poor schmo had quite literally bet the ranch on WorldCom shares continuing to climb and had also locked himself into illiquid assets, so he had no downside protection if the market, or WorldCom, crashed.

Yet another flurry of negative press stories followed, from broad pieces decrying the collapse of the telecom industry to a *New York Times* piece on executives in trouble, featuring the indignity of poor Bernie having had to sell his 118-foot yacht, *Aquasition.*[3] Bernie lost a yacht. Tens of thousands of his employees were going to lose everything. And, if Bernie defaulted, WorldCom shareholders would pay the price for his and his board's bad decisions. All he'd have to do would be to declare bankruptcy. Then he could start over—not as a mogul, of course, but probably not delivering milk either.

The day after the SEC inquiry was announced, Salomon Smith Barney's chief strategist, Tobias Levkovich, removed WorldCom from SSB's "Focus List" of stocks to buy. Yes, it had been on that list throughout all of the earnings misses and warnings. And why not? Its top analyst, Jack Grubman, still had it as a "1" or Buy. But now even Levkovich, no telecom expert, thought it was time to bail, citing the uncertain outcome of the SEC inquiry.

Sensing more and more vulnerability on the part of the investment banks, New York State attorney general Eliot Spitzer turned up the heat on his probes of the conflicts of interest between research and banking. He made public some of the e-mails written by Merrill Internet stock analyst Henry Blodget, referring to a stock Blodget had recommended with a Buy rating as a "dog," and others he referred to as "POS," for "pieces of shit." He also announced that he was expanding his probe to other banks. Spitzer didn't name names, but we all knew he probably meant CSFB, Morgan Stanley, and Salomon Smith Barney. And indeed, on April 29, *Business Week* reported that Jack Grubman had become a target of Spitzer's ongoing investigation of analysts, along with SSB.[4]

To try to steal some of the regulators' thunder, banks such as Merrill and CSFB hustled to announce their own reforms, including prohibiting analysts' compensation from being tied to specific investment banking deals, though they did not offer to stop funding research departments with money from their investment banking departments. It was amazing to see these firms scramble after denying for so long that there was anything questionable about the way they did business.

On April 19, 2002, WorldCom again warned of an earnings shortfall, forecasting financial targets that were much worse than expected. With the Bernie loan debacle and the SEC investigation, it was enough to make me decide that the company's survival was in real question. So three days later, quite belatedly I admit, I sounded the death knell, lowering my rating from Hold to Sell—the second Sell of my career and the first in many years. I cut my target price dramatically, from $9 to $2. I wrote: "…[The] only exit is takeout by [a Baby Bell] but we believe [the Bells] are highly unlikely to take on $30B of debt, negative revenue growth and inevitable loss of share and pricing power."

I wasn't the only person to lower the boom on WorldCom shares, although I was one of the few to go to a Sell. Goldman and JP Morgan also downgraded the stock. And, finally, so did Jack Grubman, who

was already having a pretty scary week with the announcement of Spitzer's probe. He dropped his rating two notches from a Buy, or "1," to a Neutral, or "3," citing the SEC investigation and the debt problems.

His report, titled "WCOM: Dramatic Change in EBITDA Guid. [*sic*] Too Much to Ignore," was telling even in its title. God knows he'd ignored all the other bad news coming out of the company for the previous few years—but I guess this was really too much, even for him.[5] Surprisingly, Jack still had followers: WorldCom's stock fell by a third on the news, from $5.98 to $4.01 per share.

On April 25, WorldCom reported terrible earnings per share and revenue growth. And then, on April 30, the once-unthinkable news broke that Bernie Ebbers—Jack's starmaker—was out, having resigned under pressure from the board. Not only was he getting the boot for WorldCom's horrendous performance, but his financial difficulties had compounded with each downward tick of the stock to the point that he was virtually insolvent. I guess the board finally concluded that it's hard to carry out your fiduciary duties to the shareholders when you owe them $400 million yourself. Maybe the board should have thought about that before they loaned him the money. John Sidgmore, the former CEO of MFS subsidiary UUNet, who had joined WorldCom's board after it snapped up his company, became the acting CEO.

Jack, meanwhile, had replaced the younger and blonder Henry Blodget as the public face of the bear market. The April issue of *Money* magazine, a publication that had glorified the stock market, put him on its cover. Its title: "Is Jack Grubman the Worst Analyst Ever?" Street people didn't read *Money* for the most part—it was aimed at the individual investor—but this copy was dog-eared by the time it had made the rounds of our offices. It essentially blamed Jack for the entire telecom bubble. "People hung on his every utterance," it said. "When he spoke, stocks moved."

Jack wasn't the only telecom hero to suffer an abrupt reversal. A month earlier, in March, Qwest had also come into the crosshairs of the SEC, which was investigating its accounting, focusing particularly on its use of swaps to bolster revenues. The stock was now trading at around $9, down from a high of $66 just two years earlier, with its employees' pension funds virtually wiped out. Joe Nacchio, however, had cashed in stock options worth $74.6 million in 2001 alone and, just five months earlier, had even had his contract renewed until

2005.

But suddenly, Qwest's long-supportive board had a change of heart. Nacchio, too, had to go. Phil Anschutz, Qwest's chairman, did the dirty work. On June 14, he got on his private jet and flew to a private airport in New Jersey to break the news in person to Joe, who met him there.[6] Ever the salesman, Joe tried to convince Phil otherwise, but his charm had worn thin. And though the board could have made the case that he was being fired for cause due to the accounting investigations, in which case he wouldn't be eligible for any severance, it let him leave with a $12 million payout plus a $3 million consulting contract for two years. Joe left rich in dollars but not reputation, his grand strategy disgraced and discredited. He had done what I thought no man ever could: he had come close to destroying a Baby Bell, a cash cow if ever there was one.

But he either couldn't or wouldn't acknowledge that he had any responsibility in the debacle. Drake Tempest, Qwest's general counsel, organized a good-bye dinner for Joe and most of his top staff in a private room at an Italian restaurant in downtown Denver. According to one person who was there, Joe made an emotional speech lamenting the unfairness of life. He insisted that he'd tried to do what was right for the company and the employees. He then quoted some biblical passages about being betrayed and getting revenge, telling everyone that he was not going away. Apparently, he saw Phil Anschutz as his Judas.

A few weeks later, the U.S. Department of Justice opened a formal investigation into Qwest's conduct. Five midlevel executives have been indicted so far, two of whom have pleaded guilty. Not until March 15, 2005, after nearly three long years had passed, did the law touch Joe. The SEC filed civil charges against him as well as two of his former CFOs, Robin Szeliga and Robert Woodruff, former COO Afshin Mohebbi, and three other executives, alleging that they orchestrated a "massive financial fraud."[7]

The SEC complaint cited Qwest's "culture of fear" and alleged that "Qwest relied so heavily on the immediate revenue recognition from one-time IRU and equipment sales transactions to meet the aggressive revenue and growth targets that Qwest management and employees referred to the practice as a 'drug,' an 'addiction,' 'heroin,' and 'cocaine on steroids.' Moreover, Qwest's reliance on so-called IRU 'swap' transactions to meet revenue targets led some in the company to refer sarcastically to those transactions as 'SLUTs' (short for Simultaneous Legally Unrelated Transactions)."[8]

On June 5, 2005, Robin Szeliga agreed to plead guilty to insider trading and cooperate in the ongoing investigations. Nacchio's trial is expected to begin in early 2006. Maybe I'll sit in.

WorldCon

The telecom and overall market implosions were in full force. Investors had been wiped out, employees were being laid off weekly at most of the major telecom companies, and we walked around in a state of numbness. What else could go wrong? In mid-June, I became convinced that WorldCom was not even likely to survive the summer, based on its downward-spiraling numbers. Ido and I tried to come up with a valuation for the company based on our best guess of the real numbers.

The target price we came up with was, amazingly, zero, though the shares were trading at almost a dollar. That reflected the fact that the company's massive amount of debt, roughly $30 billion, exceeded our estimate of the value of its assets. In effect, after paying off bondholders, there would be no value left for shareholders and bankruptcy was imminent.

We wrote a report highlighting the zero target price and reiterating our Sell rating. CNBC's Maria Bartiromo, known on the Street as the "Money Honey," ridiculed our target price, as if a zero valuation was preposterous. Right around the same time, in a report dated June 21 but distributed the following Monday, June 24, Jack cut his rating on WorldCom again, to Underperform, or "4," from Neutral. The stock was trading at $1.22 per share on June 21 and closed at 91 cents on the 24th.

Just after Jack's downgrade, I flew out to Kansas City to speak at a strategy meeting for Sprint executives. WorldCom was in free fall, but the outlook for other long distance companies wasn't appreciably better. WorldCom's efficiencies and synergies had been, up until now, the envy of executives at Sprint and AT&T. Even as WorldCom faltered, executives at AT&T and Sprint remained completely obsessed with understanding how WorldCom managed to get its costs so much lower than their own. So the Sprint folks asked me to come explain how and why WorldCom consistently reported vastly lower cost ratios and thus better profit margins than Sprint. They hoped my words would help to crank up the energy level and get their executives fired up to compete, WorldCom style.

We were all about to find out exactly what that meant. The night before my presentation, I went out to dinner at a steak and brew pub with Steve Fletcher, a former colleague from MCI who was now vice president of strategic planning at Sprint. We hadn't known each other very well at MCI, but we did know a lot of folks in common. We ordered beers and reminisced about MCI when it was still a scrappy startup.

We had just started to talk about our kids when my BlackBerry started vibrating insistently. I couldn't stop myself from stealing a glance at the screen. Rude, I know, but in this business everyone understood. You just never knew what was about to happen.

But this one I could never have anticipated. I glimpsed the headline and choked on my beer.

"Oh, my God," I gasped. "You're not going to believe this."

I held my BlackBerry up to Steve's eye level. I saw his pupils dilate as he read the headline that I'd just seen: "WorldCom Restates $3.8 Billion; CFO Sullivan Out." WorldCom was announcing that it had overstated its financial results by almost 70 percent over the past 18 months.

"Holy Shit!" he blurted, probably just one of thousands of "Holy Shit's" being uttered at that exact moment all over the globe. "What the hell is going on here?"

We had all experienced so many disappointments and reversals over the last few years that I thought I had lost the ability to be shocked by anything. But this one really threw me. I knew that Global and Qwest seemed to have pushed the envelope on a lot of stuff, and that the collapse of Enron had put every chief executive on the defensive, but this was utterly beyond the scope of what I could fathom.

First was the enormity of the numbers: $3.8 billion in missing operating cash flow? In a company whose total operating cash flow was reported at $9.3 billion last year? It was a number so large that it embarrassed everyone who had anything to do with this company. It meant that the company's profits for at least the previous year, perhaps longer, had been zilch. Why hadn't Andersen, the auditing firm, noticed almost $4 billion in errors? Why hadn't the bankers who were always ready to help WorldCom sell another slug of stock or debt seen anything? What about internal executives? The board of

directors? The SEC? And, of course, the analysts? As dazed as I was by the news, it wouldn't be long until WorldCom's investors were wishing the restatement were only $3.8 billion.

Then there was the Scott Sullivan factor. Scott? The straightlaced, monotonal numbers guy who always had total recall of every component of WorldCom's balance sheet and income statement? It had been an impressive quality. Too impressive, perhaps.

Steve and I stared at each other. We instantly knew that this was the end of both a company and an era. All of this navel-gazing and soul-searching on the part of so many companies trying to replicate the WorldCom magic had been for naught. All this strategizing and firing and hiring and relocating and repricing to try to catch up to a company that had been a complete sham was instead a cruel joke. In reality, there was no way to outdo WorldCom with fiber-optic wires, computer software, and clever marketing. All you really needed was a CFO with a pencil and an eraser.

We talked in rapid-fire bursts, the way people do when something terrible happens. I felt numb inside. Sure I had a Sell on the stock, and sure I'd been considerably more cautious than my competitors for the past two years, but I'd had no inkling that there could be something so sinister going on. Why not? And why didn't anyone else? What about Jack? I wondered. Did he know? Or did Scott dupe him as well? That would be one amazing irony—the insider led astray by his inside connection. As with so many of the questions that had arisen in the past year, I had no answers.

The next morning, I showed up for my presentation to Sprint's executives with no idea of what to say. I made it through the speech on autopilot, sarcastically commenting that I had been planning to tell everyone how they could become more like WorldCom. My mind was back in that dingy office in Jackson, Mississippi, where Bernie had showed me his handwritten notes on acquisitions.

I thought, too, about my former colleagues at MCI. Those who had stayed on through the WorldCom acquisition had probably lost their life savings by now. And then, of course, there were the investors, large and small, who gambled big on the stock and lost, but had been playing the whole time with a deck stacked against them. One thing was not debatable: Mark Bruneau, the consultant who had called WorldCom the "poster child for buying real things with fake money" in that April 2000 *Fortune* article, had been more accurate than he ever could have imagined.

The publicity-shy Sullivan immediately found his name splashed across the front page of every newspaper in the country and many around the world. But he was not the only one to feel the heat of a furious public. The next morning, CNBC reporter Mike Huckman conducted an old-fashioned stakeout in front of Jack Grubman's post Upper East Side town house near the Metropolitan Museum of Art. When Jack emerged only to see the cameras rolling, he visibly blanched and tried to keep walking, but Huckman kept up the pace—and unleashed a torrent of aggressive questions.

Jack came off looking shifty. "Look, could you—first of all, this is a huge invasion of privacy," he said, trying to outpace the reporter. Huckman asked if Jack had known anything about WorldCom's disaster in advance. "Nobody saw this coming," he said. "I'm no different from anyone else on Wall Street." His shoulders were hunched, his body language defensive. But he still couldn't keep his damn mouth shut!

"I mean, what [*sic*] are you harassing like this?" Jack whined, his voice even squeakier than usual.

"I'm not harassing you," said Huckman. "I'm just asking you questions about the company that you cover. Do you think WorldCom can survive?"

"Look," he sputtered. "I have no, I have no comment. I'm as shocked about this as everyone else."

The video clip zipped around the Street quicker than a Roger Clemens fastball. Jack looked so pathetic that I actually felt bad for him for a moment. Shouldn't he be allowed to walk freely in his own neighborhood? Then I caught myself and thought about what many now viewed as an endless stream of hype and deception that had spilled from his lips over the past decade.

The next day, the House Financial Services Committee subpoenaed Jack, Bernie, Scott, and Melvin Dick, the Andersen accountant in charge of the WorldCom audit, requiring them to appear at a televised hearing about the downfall of the company.

The thought of having to walk in Jack's shoes for a city block nearly made my heart stop. What if the committee asked me to testify too? Even if they wanted me as a counterexample to Jack, which didn't seem likely given the witch-hunt atmosphere, I had no interest

in standing next to these questionable characters in front of a bunch of bloodthirsty politicians. Certainly the reputation of analysts was so soiled by now that I'd be a victim of guilt by association. Plus, I realized, there were plenty of embarrassing questions that they could ask me, such as why it had taken me so long to go to a Sell rating on WorldCom or why I had been bullish on Qwest for so long. So mixed in with my anger at Bernie, Scott, and Jack and my gratification that they were finally being called to account was quite a bit of worry that —in the public perception anyhow—I would be viewed as one of them.

The House hearings on WorldCom began on July 8, 2002. I stayed home that day so that I could watch them. It was, for anyone in my business, the ultimate reality television show. All four of them looked as if they'd aged about 20 years in the last one. Mel Dick looked bewildered. Bernie's cowboy jauntiness now looked stiff; Scott's once–crisp, precise demeanor was now tense and clipped; and Jack looked as if he'd spent the previous night on a barstool. He'd never done a lot of television and you could see why.

Scott, who would be arrested three weeks later along with his controller, David Myers, took the Fifth Amendment and just sat there, listening mutely as the committee members railed against WorldCom's restatement of what was now believed to be over $7 billion. This number was so huge as to be almost incomprehensible. Things didn't get easier to comprehend when the number jumped up to $11 billion by April 3, 2003, replacing Enron as the largest corporate fraud in history.

Bernie, dressed in a blue suit with a red-striped tie, read a prepared statement. He would speak, he said, "…when all the activities at WorldCom are fully aired and when I get the opportunity…to explain my actions in a setting that will not compromise my ability to defend myself…I believe that no one will conclude that I engaged in any criminal or fraudulent conduct during my tenure at WorldCom. Until that time, however, I must respectfully decline to answer the questions of this committee on the basis of my Fifth Amendment privilege."

Next came Mel Dick, the former Andersen accountant and now CEO of an apparel company. He passed the buck. "The fundamental premise of financial reporting is that financial statements of a company, in this case WorldCom, are the responsibility of a company's management, not its outside auditors," he said.

Finally, it was Jack's turn. And as always, he talked. Dressed in a navy suit, white shirt, and blue tie, his dark hair thinning, his angular face stretched thin, he looked like a mouse—a mouse caught in a trap.

"Let me say I am saddened by why we are here," he said. "I am saddened that people lost money, I am saddened that people lost jobs. I am saddened that a major company is enmeshed in a major scandal, but I want to commend you and everybody on this committee for acting quickly to try to find out what went wrong here," he said. "WorldCom fit my long-held, honestly held investment thesis that newer, more nimbler [*sic*] companies would create value…. I am aware that there is speculation that I had advance knowledge of this fraud. That speculation is categorically false."

Whatever the politicians thought of that statement, they didn't go easy on Jack. They grilled him on WorldCom, repeatedly probing whether his ratings were driven by Salomon Smith Barney's banking interests. And then they threw him a curve ball, asking him about "special IPO [shares] to executives of WorldCom."

What they were asking about was the phenomenon of IPO spinning, in which investment banks gave corporate executives shares in companies about to go public, allegedly in return for those executives sending business to those investment banks. In effect, spinning was a quid pro quo, or a payoff: in return for a company's choosing a certain bank, its top executives would get a special bonus of a few thousand shares of stock in companies that bank was about to take public. This way, the executives would get the almost guaranteed quick profit that accompanied hot IPOs. Apparently, Salomon Smith Barney had been pretty expert at this game. I had only heard about spinning by reading it in the paper, but I quickly realized it must have been going on all around me for quite some time.

I suddenly flashed back to a strange conversation with Clark McLeod, CEO of McLeodUSA Communications, in late 1997. McLeodUSA was a startup local phone company headquartered in Iowa and covered by my colleague Mark Kastan. McLeod himself was a former schoolteacher who'd taken a flier on telecom, much as Bernie had, and had scored big before the you-know-what hit the fan.

Clark had never called me before, so I was surprised to hear his voice. I figured he either wanted to hear my views on the sector and his company's place in it or had a complaint about Mark's research. But he had something else on his mind. He asked me, instead, if I could get him some shares in the upcoming Teligent IPO.

Teligent was another startup local phone company, run by Alex Mandl, the former president of AT&T. It planned to use the less expensive wireless technology instead of fiber to carry the local portion of calls for business customers. Salomon and my firm at the time, Merrill, were the lead bankers for its IPO and thus determined which investors received shares the day of the offering.

It took me a while to realize that he was asking me to get him on the "friends and family" list of people who received shares in advance of an IPO. Usually, the only people who got pre-IPO shares were executives and employees of the company and a very small list of people whom the executives designated—hence the "friends and family" term. With the IPO market as hot as it was, anyone with these shares would probably see a significant firstday pop in the stock and, if they sold into the market, could make some serious dough very quickly.

I didn't know what to tell this guy. I didn't understand why he thought I had anything to do with handing out IPO shares, and it made me very uncomfortable. "Do you have a Merrill broker?" I asked. "That's probably your best bet."

"No," he said, "But I can get shares in IPOs from Salomon and I wondered if there was anything you could do for me."

I sputtered that I'd try to help him and got off the phone, both perplexed and a bit worried. What was Salomon doing now? I called up a guy I knew on Merrill's syndicate desk, which is in charge of allocating IPO shares, and told him the story.

"There's not much we can do," he said. "We don't do that." Whatever "that" was, I didn't really want to know more about it. I left it with him and washed my hands of the whole thing. Merrill Lynch was never named in the investigations that followed. But now, in 2002, this technique, which had somehow gotten the name "spinning," was all over the news.

I suddenly understood what I had been too naïve to comprehend before: someone at Salomon, possibly Jack, was able to exert "special" insider influence in yet another way—by making sure his nearest and dearest telecom execs got IPO shares. But it wasn't just Salomon. It would later be alleged that Frank Quattrone of CSFB, my firm, was one of the most blatant users of this innovative approach to customer service. Combined with the earlier scandal, in which inflated commissions were charged for hot IPO shares, Frank was in serious,

serious trouble. He'd had his contract renegotiated the previous year by John Mack to one that no longer gave him a big piece of the action (not that there was any action anymore), and word had it that he was in very hot legal water. I thought to myself once again what a good move it had been to have negotiated a chain of command that went nowhere near him.

But at this moment it was Jack who was on the congressional hot seat, and when asked whether he knew about Salomon's spinning of IPO shares to telecom executives, he suddenly looked as if he had swallowed a few chili peppers. Rather than deflecting the question, Jack, as always, opened his mouth.

"I'm trying to think if I can answer that specifically yes or no," he stammered, trying to have it both ways as usual. "I just don't recall because that's not something I would be involved with. So I can't recall. I'm not saying no; I'm not saying yes. I just can't recall."[9] The answer made him look even slimier, if that were possible.

I watched, riveted by the testimony, with an odd mixture of relief and dread. Finally, finally, Jack was getting his. I wanted to feel victorious, but instead I felt nervous. I wondered if there was any chance that I'd end up testifying before millions of people too. The previous weeks had taught me that public opinion can turn on a dime.

Just look at Jack. He had been a hero for so many years, and now the whole world assumed he was a total crook. In fact, the press seemed convinced that he knew about and had perhaps had a part in orchestrating WorldCom's massive fraud. Clients later e-mailed me that Jack had come off terribly, managing to appear both squirrelly and uncaring about the amounts of money lost.

But no one asked Jack about inside information, which I saw as the key to his success. I was glad the hammer was finally coming down on Jack, but I thought the investigators were missing a lot too. The problem was not that Jack had had a hand in WorldCom's fraud, because it was unlikely he had. The problem was that IPO shares were getting spun, certain investors got insider information, and the rest of the investing public was playing in a rigged game and didn't even know it.

BY THIS TIME my marketing had come to a halt, and my research had slowed down a lot too. Partly it was because I was spending so much

time chewing over the WorldCom disaster and trying to figure out why everyone (including me) had missed such a colossal fraud. Had we simply been duped, or had we been the best-paid people on the planet to have done the worst job?

Partly it was because several of my stocks had essentially ceased to exist. But mostly it was because I was done. The analyst role had shifted from anonymous wonk to glamorous networker and rainmaker to pathetic pariah, and I just wanted to make it to my early retirement date. I had only a few more months to go.

On July 21, 2002, WorldCom filed for bankruptcy. People had been totally horrified by the size and scope of Enron's bankruptcy the previous December—the largest ever in American financial history, eliminating $70 billion dollars of shareholder value—until WorldCom took over the top spot just months later. It was an utterly ignominious end to the fairy tale that had begun with a milkman turned gym teacher and a bunch of scribbles on a napkin. Scott Sullivan was probably facing indictment, and so was Bernie—who, unlike many CEOs in trouble, was facing financial ruin as well.

The fraud, it turned out, had occurred mostly in the way line costs were accounted for. Line costs were those costs WorldCom paid to local phone carriers for originating and completing phone calls (the so-called last mile) and were WorldCom's single largest expense. Apparently, Scott Sullivan and whoever else knew about it had decided to capitalize line costs, which meant spreading the costs over ten or more years instead of over one year, which juiced earnings and just so happened to be totally inconsistent with accounting rules. The idea of messing with such a large and important part of a company's business was so audacious that it never occurred to most people that someone would try to do such a thing. It was the elephant in the room, the fraud too huge to fathom. Any auditor should have seen it a mile away. But somehow, neither Andersen—nor anyone else—ever did.

WorldCom had gone bust with Bernie Ebbers, its former CEO, still owing it an unbelievable $400 million. He was still on the hook, even with the company's bankruptcy filing, and had five years to pay back his debts. He owned 17 million nearly worthless shares of WorldCom, along with a yacht-building business, a soybean farm, a timber business, a stake in a refrigerated trucking company, and the Canadian ranch.[10] These were not the sorts of assets that could be easily liquidated to raise cash.

In the meantime, Eliot Spitzer continued to turn over rocks in the hope of finding something on which to nail Jack Grubman. Juicy little tidbits leaked out every so often to Charles Gasparino, a reporter at *The Wall Street Journal,* and a few other reporters. Jack was as famous as he'd ever been—but now for all the wrong reasons. He made the cover of the August 5, 2002, *Business Week.* The headline: "Inside the Telecom Game: How Salomon's Jack Grubman wheeled and dealed with WorldCom, Qwest, Global Crossing, and others."[11] The story essentially blamed Jack for the collapse of the entire industry. The mania was still present, just reversed: if the market had once believed Jack was responsible for the rise in Telecom Wonderland, now he was just as culpable for its fall. Even I thought that was going too far.

Jack's regular morning run didn't guarantee him any relief either. One August morning, he literally ran into Spitzer himself in Central Park, who, in an uncharacteristic display of goodwill, jogged up alongside him and shook his hand. Jack, trying to blame the system, said, "Conflicts are inherent on Wall Street."[12] Spitzer agreed. That's true, I thought while reading the press reports of the impromptu meeting, but the real issue was how individuals chose to handle them.

By the middle of August, it was clear that Jack's support from the top of Salomon Smith Barney and, its owner, Citigroup, had evaporated as quickly as WorldCom's market value. Press reports suggested that Sandy Weill had watched Grubman's congressional testimony and was peeved.[13] On August 15, Jack announced his resignation from Salomon Smith Barney, though not before he had received a $32 million severance package consisting of stock, options, forgiveness of a loan, a consulting contract, and an agreement by Citi to pay his legal expenses, which were likely to run in the millions. In exchange, he would sign a confidentiality agreement—thus, Citi apparently hoped, keeping whatever skeletons remained in its closet carefully hidden away.

"The relentless series of negative statements about my work, all of which I believe unfairly single me out, has begun to undermine my efforts to analyze telecommunications companies," he wrote in his good-bye letter sent to colleagues and clients.[14] I finally felt a sense of closure. Even Sandy Weill, Jack's biggest benefactor and beneficiary, as it would turn out, had ditched the guy. The role Jack had redefined had come back to bite him—hard.

"What's a Level 3?"

I watched the decline of my industry and the collapse of the

reputations of some of my competitors and colleagues with a jumble of bewilderment, frustration, mortification, schadenfreude, and, perhaps most significant, relief that I wasn't going to be dragged into this mess. At least, that's what I was hoping.

But on September 30, 2002, when I got a call from a CSFB attorney named Jennifer Huffman, I couldn't help but feel my heart sink.

Spitzer was, by this point, investigating all of the major investment banks. The various regulatory agencies, from NASD to the NYSE to numerous state attorneys general, had each been assigned to investigate research practices at various banks. Huffman told me that NASD and the Massachusetts attorney general were working on CSFB and that its investigators had sent a list of 24 CSFB research analysts who might be interviewed, one of whom was me. She said the investigation covered such things as IPO spinning and biased, potentially fraudulent, research—the same issues that Spitzer had brought out in the open in his investigations of Merrill Lynch with Henry Blodget and Salomon Smith Barney with Jack Grubman.

Indeed, on that same day, Spitzer filed suit against five telecom executives, charging them with making $28 million in illegal IPO gains—Joe Nacchio, Metromedia Fiber Network chairman Stephen Garofalo, Qwest chairman Phil Anschutz, Bernie Ebbers, and Clark McLeod, my IPO-seeking buddy from McLeodUSA. All of them had used Salomon as their banker. And they'd all allegedly been personally rewarded for doing so by being granted pre-IPO shares in hot SSB-underwritten stocks. The suit sought fines of $28 million as well as the return of over $1.6 billion obtained through sales of shares in their own companies. Ebbers, Anschutz, Nacchio, and Garofalo settled the charges, paying $6.3 million in aggregate, far less than their alleged IPO profits. They neither admitted nor denied guilt. The case against McLeod remains open.

CSFB would pay all my legal expenses related to the investigation, CSFB's Huffman said, using the top New York law firm Davis, Polk & Wardwell, but I could choose an additional lawyer to personally represent me if I wished. I jumped at the chance, figuring two heads were always better than one and that I should be ready just in case CSFB wanted me to answer questions in a way that made me uncomfortable. So Huffman set me up with another lawyer, David Fein of Wiggin and Dana, a New York University Law School graduate who had been a prosecutor with the U.S. Attorney's Office in Manhattan and associate counsel in the Clinton White House. David's

job was to find out what, if anything, in my background presented a potential problem, and to prep me for a meeting with Davis Polk's lawyers, who, along with David, would be preparing me for a possible meeting with the NASD.

The goal, I soon learned, was to answer truthfully, but succinctly. In other words, they wanted me to give yes or no answers without speculating or hypothesizing. In effect, they wanted me to avoid giving any of the kind of analytical or predictive answers I had been providing for the past 14 years. CSFB sent five enormous boxes containing my e-mails and research reports for David to review. I also received copies and spent several days reading over them myself. NASD also asked for my trading records and my CSFB personnel file.

On October 7, David and two of his associates grilled me for three hours, aggressively jabbing me with a nonstop series of questions. They included the following:

—*Describe your CSFB employment contract. Does it provide for you to be paid for banking successes?* It didn't, of course—though it easily could have, had I accepted that contract proposal that gave me a piece of the investment banking department's profits.

—*When you moved from Merrill Lynch to CSFB, did any clients or business move with you?* I explained that all the sell-side analysts have the same buy-side clients, so the answer was that of course all the clients moved with me. What he meant, of course, was did any banking clients switch to CSFB when I did. The answer was no.

—*Did Bernie Ebbers attend your conferences?* Yep, he did, but not after I downgraded his stock.

—*How many* Holds *and* Sells *did you have? And what did those terms mean to you?* I went through the Holds over the years and the Sell on WorldCom and the Sell many years earlier on Ameritech. I explained what those ratings meant and how I usually didn't waste effort on stocks that I saw as unattractive or that didn't fit into my fairly traditional definition of telecom services.

—*Did you ever publish an opinion on a stock that was inconsistent with your analytical conclusions on that stock?* No, I replied.

The lawyers were satisfied with my answers, it seemed. They also really liked my contract because it didn't tie my pay to banking. So, once again, did I.

Three days later, we had a similar session at Davis Polk, where I was interrogated even more aggressively in preparation for what might lie ahead. At this meeting, my attorney, David Fein, told me that the NASD had asked for copies of all my e-mails between July 1999 and July 2001 and that Eliot Spitzer's office would get copies of them as well. It's terrifying to think of someone else going through every thing you've put in writing for the past few years in the hope of finding a smoking gun. I couldn't help but feel violated, even though I understood why they needed to do it. But I wasn't very concerned. I told David I didn't have any incriminating e-mails and I was happy to help. I had thought they asked all of the right questions, with the exception of the biggie: inside information. No one, apparently, was pursuing this topic.

So I was pretty surprised a week or so later when the phone rang and it was David.

"What's a Level 3?" he asked nonchalantly.

It turned out that the paralegals at Davis Polk had been assigned to read all of my e-mails, looking for anything incriminating, such as a situation where I privately criticized a stock while recommending it in my reports. They found an e-mail I wrote to Frank Quattrone, dated October 10, 2000, that read:

"Enough. I gave on Level 3 and that's it."

From a paralegal's perspective, this sure sounded juicy. Wasn't there a numeric stock rating system at CSFB where "1" equals Strong Buy, "2" equals Buy, and "3" equals Hold? It sure sounded as if I had caved by rating some stock a Buy or Strong Buy when I believed it should be a (level) "3."

What actually had happened, I explained, was that after CSFB merged with Donaldson Lufkin & Jenrette in 2000, DLJ's Internet analyst, who had previously covered Level 3, the Internet/telecommunications company, and another startup local telecom company, Metromedia Fiber Network (MFN), wanted to continue covering both of them.

Frank Quattrone was in the highly unusual position of being a

banker who had the technology research team report directly to him. So he e-mailed me and asked if I would be willing to transfer coverage to the new guy. I was more than happy to give up Level 3, since I wasn't going to cover it anyway, but told Frank that it made no sense for MFN to be covered by anyone but Mark Kastan. Hence my e-mail.

Those poor paralegals. They had stayed up all night going through my e-mails and finally thought they had caught me! David and I had a good laugh at a time when not many people were laughing about anything. That was the end of the exchange and the last thing the lawyers asked me about. I never heard from any of the investigators on the analyst independence issue and still haven't to this day.

Sex, Lies, and Videotape

The next round of congressional hearings began on October 1, 2002. Joe Nacchio and Gary Winnick were summoned to testify. Also testifying were several Qwest and Global Crossing employees who had lost their life savings investing in their company's stock. "I'd like to congratulate Joe Nacchio on taking—having taken such good care of his children," said Paula Smith, a woman who had worked for US West, the predecessor of Qwest, since 1980 and who had seen the $240,000 she'd saved for her daughters' education wiped out. "I really wonder if he would be willing to help me educate my children."

Gary Winnick, who looked bloated, either from too many cookies or with misplaced pride, was next up. The committee members excoriated him for his stock sales on May 23, 2001, not long before the meeting I hosted with Global Crossing that called into question the sustainability of the company's revenue growth. He denied having any inside negative information and then, in a masterful public relations move, announced that he would contribute $25 million to restore some of the 401(k) losses suffered by Global employees.

The congressmen, who moments ago had been thirsting for Gary Winnick's blood, went silent. How could they beat up a guy who just gave $25 million of his own money to their poor constituents? Never mind that those Frontier and Global Crossing employees had lost hundreds of millions of dollars and that $25 million was peanuts for him, only 3.5 percent of the over $700 million of Global Crossing shares he had sold before the stock crashed. When Joe Nacchio, who had himself cashed out of $216 million in salary, bonus, Qwest stock, and options between 1999 and 2001,[15] was later asked whether he would do the same, he dodged the question. Qwest, he reminded everyone, was not bankrupt—though its stock was now selling for less

than $2 per share.

Watching the spectacle of these hearings made me more convinced than ever that it was time for me to phase out. After Ehud left, it hadn't been clear who should succeed me. Though Ido and Julia were well qualified and perfectly positioned to do so, there was concern from the top brass that they didn't have enough experience yet. So the decision was made to ask Lara Warner, CSFB's cable TV analyst, who had been Blake ("Bloodbath") Bath's assistant at Lehman Brothers several years back, to become CSFB's senior U.S. telecom analyst. I thought it was a good idea. Lara was already at CSFB, and she had worked at AT&T and then at Lehman covering telecom, so she had a lot of experience.

As of January 16, 2003, I would take on an advisory role as the firm's global telecom strategist. My new job would be to recommend to CSFB's clients a global portfolio of telecom stocks, telling investors how much of their portfolios should be invested in telecom versus other sectors, and which parts of the world and specific companies looked most attractive for investment. It was a big picture view compared to the range I'd had before. It meant quarterly deadlines instead of daily crises and big-picture thinking instead of detailed company modeling.

I should have asked for this a long time ago, I thought to myself, as I started the transition process. I was burnt-out, exhausted, and depressed about the current state of affairs. I'd been both very right and very wrong in my career, but my industry was in a shambles, thanks to a potent mix of overcapacity, underwhelming demand, and good old-fashioned fraud.

I had done very little marketing that year, as the events of September 11 had sapped my will to globe-trot in a frenetic search for votes. For the first time, I didn't really care whether I made number one on the *I.I.* list (I made number two in 2002, behind Morgan Stanley's Simon Flannery, the analyst with the prescient negative call on Qwest). My new strategist role didn't require me to be in the office that much. It was weird. I felt guilty, as if I were working half-time, even though I was putting in 40–45 hours per week. Effectively, I was working only 60 percent as much as I had for so many years. I even started taking a film class, seeking to catch up on some of the decades of culture I'd missed.

But just as I began to wind down, the case against Jack began to ramp up in a very serious way. Spitzer's team had subpoenaed

virtually all of Jack's e-mails over the past several years in search of something damning. And in the fall of 2002, they found what they'd been looking for and a whole lot more, mostly relating to Jack's upgrade of AT&T shares back in November 1999. What I had believed was a straightforward quid pro quo that traded positive research for banking in order to help win a piece of the AT&T Wireless IPO deal was actually much weirder, and a whole lot more sordid, than that.

It was a tale that had everything from scheming CEOs to kids to sex (or virtual sex, at least). All tied up in Jack's upgrade, Spitzer would allege, was Citigroup CEO and Jack's boss Sandy Weill's desire to rid himself of his co-CEO, John Reed; AT&T boss Michael Armstrong's desire to make Jack a bull on his stock; and—in the pièce de résistance—Jack's desire to get his boy and girl twins into one of the most exclusive preschools in Manhattan, the 92nd Street Y. Even I played an unwitting cameo role in the saga, I would later learn.

In November of 2002, *The Wall Street Journal* and *The New York Times* ran a few blockbuster stories quoting from some e-mails that Jack had sent to "a friend" in early 2001 and that had been leaked to the press, presumably by Spitzer's investigators or some deep throat at Citigroup.[16] That "friend" was actually a buy-side analyst named Carol Cutler, and I knew her fairly well, though not the same way Jack did, I soon found out.

Carol Cutler was a New York-based telecom analyst for the government of Singapore's massive investment fund, a major client of both Jack's and mine. A 40ish, artsy type with long red hair, she and I had had several run-ins, the most unpleasant of which occurred in early 2000, when Ehud and I lowered the forecast and target price for Williams Communications, a long distance startup. Well, Carol must have been loaded up with Williams shares. Just a few hours after our report was published, she called Ehud, who had written it, and left him a scathing voice mail telling him that our valuation methodology was horribly flawed.

"I know [this] methodology better than anyone," Carol hissed. "You guys made huge mistakes in your report. Your target price should be going up, not down." Ehud forwarded the message to me. I was astonished. Though I would never say "better than anyone," Ehud and I did know how to do our jobs. I didn't think our methods or assumptions were off base. They certainly weren't deserving of such scathing remarks. It was pretty unusual for a client to be so angry about a fairly uncontroversial report like this one.

I didn't figure out what her problem was—not until late 2002, that is, when I read Charles Gasparino's *Journal* story detailing some of the findings of Spitzer's investigation of Jack. It said, among many other things, that Carol and Jack had been having a steamy e-mail affair of sorts, with lots of digital fantasizing.[17] Perhaps Jack's disdain for me had rubbed off on his virtual paramour.

The *Journal*'s story also said that those e-mails contained a motive for Jack's upgrade of AT&T. The truly crazy thing was that the e-mail conversation that ultimately cost Jack his reputation, $15 million in fines, and his job began with sexually-tinged insults about—bizarrely—me! As I later learned from reporter Gasparino, who was working on a book about Jack, Mary Meeker and Henry Blodget, Carol and Jack had a special nickname for me: DW, which alternately stood for either "dimwit" or "Dickless Wonder." Some choice!

One day in early 2001, I guess to get on Jack's good side, Carol wrote Jack the following e-mail: "DW has a big fantasy about you. He wants to give you a blowjob. Can you believe that! He's heard your reputation for being a Svengali so now he has this fantasy that if he drinks from the well then maybe he will finally understand telecom, what drives it and how it works…."[18]

Yikes.

I guess what Carol was doing was playing to Jack's ego by ridiculing me. I knew what I thought of Jack and was pretty sure I knew what he thought of me, but this was not just competitive fervor. It was obsession tinged with perversion. Unbeknownst to me, I was part of a virtual ménage à trois. I was repulsed.

And that wasn't all. On January 13, 2001, Carol used me to push Jack's buttons again.

"Do you think DW could do himself, much less anyone else?" wrote Jack.

"No," Carol replied. He's "…delusional and desperate to learn anything. That's why he wants to be in the closet to watch the great one…maybe we should hook him up with fellow delusionist Armstrong," she wrote. "Now that's a perfect match made in hell."

As disgusted as I was to have been referenced in this juvenile exchange, I was ultimately glad that it at least served some purpose. Apparently, Carol's talk of me got Jack just riled up enough to expose some of his motivations for upgrading AT&T's stock from Neutral to

Buy back in late 1999, just before AT&T selected underwriters for the IPO of AT&T Wireless. “He’s already been done by Armstrong just doesn’t know it,” Jack responded, referring to me and my ill-timed upgrade of AT&T.

And then Jack laid out in living color his twisted justification for his AT&T upgrade 14 months earlier, apparently trying to dispel the notion that he had done it for something as pedestrian as $63 million in IPO underwriting fees. “You know, everybody thinks I upgraded [AT&T] to get the lead for [the AT&T wireless IPO in 2000],” he wrote. “Nope. I used Sandy to get my kids in 92nd St Y preschool (which is harder than Harvard) and Sandy needed Armstrong’s vote on our board to nuke Reed in showdown. Once coast clear for both of us (i.e., Sandy clear victor and kids confirmed) I went back to my normal negative self on T [AT&T’s ticker symbol]. Armstrong never knew that we both (Sandy and I) played him like a fiddle.”[19]

Jack later recanted his e-mails, saying that he had essentially made up all of that stuff to appear more important in Carol’s eyes. But Eliot Spitzer’s team now had ammo, and they dug into the corners of upper-crust Manhattan to decipher Jack’s note. Here’s what they found, according to the complaint later filed by the SEC.

It turned out that Jack’s negative comments on AT&T for the years prior to his upgrade had really angered Mike Armstrong, who mentioned it on several occasions to Sandy Weill, the complaint claimed. In a textbook case of interlocking directorships, Mike was on Citigroup’s board, and Sandy was on AT&T’s board. Although analysts were supposed to have their own opinions, Mike didn’t see anything wrong with trying to use his persuasive powers to get Jack to think more positively about the stock. Jack had a lowly Neutral rating on the company at the time and regularly criticized the company to anyone who would listen.

According to the SEC complaint, AT&T management complained to Sandy that Jack hadn’t called AT&T one of the “important telecommunications companies of the future” at a 1998 trade show. Sandy told some senior Salomon Smith Barney bankers, who told Jack. Jack, who had once worked at AT&T, then wrote a letter of apology to Sandy, dated October 9, 1998, which mentioned that he would also apologize to AT&T management when appropriate. “I want to make it perfectly clear,” he wrote to Weill, “that the last thing I want to do is embarrass the firm or myself or for that matter have AT&T put in an awkward position in dealing with Salomon Smith

Barney."[20]

Sometime around the beginning of 1999, Sandy asked Jack to take a "fresh look" at AT&T.[21] According to the SEC, Jack agreed to do so and sent a long questionnaire to the company, an unusual but legitimate approach when considering initiating coverage, changing an opinion, or simply writing a new report. Eventually, the company responded. Sandy then set up a meeting at AT&T for Jack with Mike and other top AT&T executives on August 5,1999. Just to put this in perspective, never in my 14 years on Wall Street did any senior executive of my firm, much less the CEO, get personally involved in the research process or arrange a meeting for me.

Jack wrote Mike a follow-up letter two weeks later, asking for the company to open its kimono a bit more and hinting at the possible outcome. "When my analysis is complete and if the results are in line with what you and I are both anticipating," he wrote, "once I'm on board there will be no better supporter than I…. As I indicated to you at our meeting, I would welcome the role of being a 'kitchen cabinet' member to you."[22] He sent copies of the letter to Sandy, the head of SSB investment banking, and the head banker covering AT&T, telegraphing where he was going.

So Jack's "fresh look" was well underway by the time AT&T's board of directors approved the idea of an IPO for its wireless business at a meeting in October 1999—a decision in which Sandy, as a board member, participated. According to the SEC's complaint, Sandy and Jack then discussed the status of Jack's analysis.

According to the investigators, Sandy was pressuring Jack for a better rating on AT&T's shares. But Jack allegedly wanted something out of it too. He was just then in the process of trying to get his twins admitted to one of the most exclusive preschools in Manhattan, the 92nd Street Y, and he wondered if Sandy could help him out.

On November 5, just over three weeks before Jack's upgrade, he sent a memo to Sandy Weill that was later released as part of Spitzer's evidence. Its title: "AT&T and 92nd Street Y."[23] Never one for subtleties, that Jack. After talking about his "good meeting" with Mike Armstrong, and discussing some more upcoming ones, he changed subjects.

"Given that it's statistically easier to get into the Harvard Freshman Class than it is to get into pre-school at the 92nd Street Y (by the way, this is a correct statement), it comes down to 'who you

know,' he wrote. "Attached is the list of the Board of Directors of the 92nd Street Y….If you feel comfortable…I would greatly appreciate it if you could ask them to use any influence they feel comfortable in using to help us as well…. Anyway, anything you could do Sandy would be greatly appreciated. As I mentioned, I will keep you posted on the progress with AT&T which I think is going well."

Jack met with AT&T executives a few more times and on November 29, 1999, to the surprise of everyone, including me, upgraded AT&T from a Neutral, or "3," rating to SSB's top rating, Buy, or "1." In an e-mail, Jack pushed SSB's publications department to hurry so his report could be "distributed in time to meet Sandy Weill's deadline (before the AT&T board meeting)."[24] His 36-page report, which came out the next day, attributed the upgrade to his new fondness for AT&T's cable telephone plans, a complete reversal of his prior position. In a fabulous coincidence, in mid-December of 1999, Sandy called a member of the 92nd Street Y board and asked for help getting Jack's twins into the school, saying he would be "very appreciative." Apparently, in Manhattan's high social circles, "very appreciative" is code for "very generous."[25]

A few months later, in March 2000, the kids got in. According to the complaint, the board member called Sandy back and then suggested a donation. It was approved in July, not to be made by Sandy personally but by Citigroup, for $1 million.

The arrangement paid off. That $1 million tax-deductible donation was a small price to pay in another way too. When AT&T selected SSB as one of the underwriters for the wireless IPO in early 2000—the one I was sure CSFB would win, the one that prompted my outburst to CFO Chuck Noski—SSB and its parent, Citigroup, collected a $63 million fee. In making its decision, AT&T assessed the views of the analysts covering its stock—much as Level 3 had done with its analyst scorecard. Jack, who had been on the company's bad side, suddenly received one of the highest possible scores. And in February of 2000, John Reed, Sandy's co-CEO at Citigroup, resigned, although every major newspaper reported that he had been forced out by Sandy and the board. That $1 million looked like a pretty darn good investment.

Jack, his work done, was no longer afraid to stand up to Sandy. He was the "Power Broker," after all. Three weeks after the AT&T Wireless IPO was completed, he allegedly began to criticize AT&T again in conversations with clients, although he didn't tell SSB's retail brokers nor did he lower his Buy rating on AT&T shares. A few weeks later, AT&T investor relations executive, Connie Weaver, wrote in an

internal e-mail to Mike Armstrong and some other AT&T executives that institutional money managers were viewing Jack's banter as a "virtual downgrade."[26]

Finally, in October 2000, he made it official. He downgraded AT&T shares twice, first from Buy, or "1," to "Outperform," or "2," and then, later in the month, down to Neutral, or "3," making a complete round-trip in less than one year. The irony, of course, was that Jack would have been right about AT&T if he had simply ignored Sandy's request for a fresh look and pursued other preschool options for his children. As it turned out, his twins attended the 92nd Street Y preschool but were not accepted into any of the private elementary schools Jack and his wife had wanted. Today, the twins attend a New York City public elementary school on the Upper East Side of Manhattan.

Both Jack and Sandy Weill denied Spitzer's allegations. Weill called the 92nd Street Y donation simply a gesture he would make for any valued Citigroup employee. Weill did admit to asking Jack to take a "fresh look" at the stock, but he said that's where it ended.[27] And Jack, under questioning by Spitzer's folks, said he wrote that incriminating e-mail to Carol Cutler because he wanted to "impress a friend."

It was clear that Carol was duly impressed by Jack already, so much so that she was offering to perform various sexual favors for him, according to multiple e-mails quoted in Gasparino's *Blood on the Street,*[28] and even trying to convince him to leave his wife, according to one account. So one of Spitzer's investigators asked him, "Why would you need to impress someone you already won over?"[29] It was a good question, a question that could be asked of a lot of Jack's actions over the past decade or so.

So Long to the Street

By the end of November 2002, most of this information had been vetted and aired in the press, thanks to a series of leaks. Yet the material was so salacious that even the investigators were reluctant to discuss it in detail. Although neither the *Journal* nor the *Times* would print the titillating parts of the e-mails, the rumors about them had certainly hit the Street.

The New York *Daily News,* however, couldn't resist making one reference. "Grubman, who is married and was then a $20 million-a-year analyst for Citigroup, was boasting about how he helped Sandy

Weill become CEO of the world's biggest financial company when the talk moved from surging stocks to oral sex. The money manager claimed to be an expert—and Grubman was intrigued," the story reported.[30] But that wasn't all: Spitzer's team had by this point found e-mails from Jack, like Henry Blodget's, in which he indicated he did not believe his own published Buy ratings on a variety of startup local phone companies for which SSB had done banking business. Although some called Spitzer's moves a witch hunt, I thought he was zeroing in on the right people. Perhaps the Street might start to clean up its act.

On December 20, 2002, Spitzer announced, with great fanfare, the preliminary outlines of a settlement with 10 investment banks, one that had involved an enormous amount of behind-the-scenes arm-twisting and poker playing. Every possible regulator managed to attach its name to the document, including the New York State Attorney General's Office, the NASD, the SEC, the NYSE, and various state agencies. Everyone wanted to be able to claim some form of victory, late as it was.

The banks agreed to pay a combined fine of $1.4 billion, with greater fines paid by those banks with greater alleged research fraud and conflicts of interest. Paying the largest fine, $400 million, was Citigroup's Salomon Smith Barney. Of that, $300 million would go to investor restitution, $75 million toward funding independent research, and another $25 million to investor education. CSFB and Merrill were fined $200 million each. And all 10 banks agreed to the following additional terms:

—A severing of direct and explicit links between research and investment banking. (That meant no more paying analysts for specific deals managed by their firm's bankers, and no more analyst participation in banking-related road shows or sales presentations.)

—A total ban on IPO spinning, the practice of investment banks currying favor with corporate executives by them giving shares in hot IPOs.

—An obligation for each of the firms to hire at least three independent research firms to give research choices to the firm's clients, in addition to its own research.

—The public disclosure of analyst conflicts.[31]

"This agreement will permanently change the way Wall Street operates," Spitzer announced, flushed with pride.

Would it really? Certainly, I was happy that finally someone had taken a hard look at our industry and dumped its dirty laundry into the Street's collective lap. I just hoped he wouldn't stop with the firms but would also take his crusade right to the door of the individuals who broke the rules. After all, I thought to myself, if firms are fined, that firm's shareholders suffer. By contrast, if individual executives are punished, shareholders will benefit because executives are more likely to behave better in the future and spend more time actually running their companies instead of lining their own pockets.

But Eliot Spitzer decided to put the brakes on. The $1.4 billion in fines, while seemingly substantial, were small when compared with the more than $80 billion in profits made by these banks over the past few years. And by allowing the accused to settle the cases, without admitting or denying guilt, Spitzer stopped his investigation in its tracks. We will never know for sure how far up the chain any of these conflicts went or how involved top Wall Street executives, including Sandy Weill, actually were in the research process. In order to create real change on Wall Street, I believe, prosecutions of Wall Streeters needed to go forward, wrongdoing had to be proven, and then heads had to roll—big ones. Unfortunately, it now looked as though this would never happen.

The feds, but not Spitzer, did, however, go after one specific individual. As 2003 dawned, the noose around Frank Quattrone's neck grew tighter and tighter. He was still at CSFB, but the word was that he could soon actually face federal indictment. On March 4, 2003, CSFB employees received a terse e-mail announcing that Frank had resigned, "effective immediately." CSFB said that "the Firm and Mr. Quattrone have agreed that it was in their respective best interests for Mr. Quattrone to separate from the Firm at this time."

Just as Martha Stewart wasn't charged with insider trading by the U.S. Attorney's Office, Frank was never charged with IPO spinning, or even encouraging fraudulent research by some tech analysts who reported to him. Instead, on May 12, 2003, he was charged with obstructing justice. The key evidence was an e-mail he had sent to his staff suggesting a routine year-end file cleanup. In 2004, after one mistrial, he was found guilty. At this writing, he faces 18 months in prison but is appealing the verdict.

On April 9, 2003, just a few weeks after my 50th birthday, I

officially left CSFB. “As most of you know,” I wrote in a note to clients and colleagues, “I have been planning for a long time to take early retirement from CSFB after 20 years in the telecom industry and 14 years on Wall Street. CSFB’s wireline telecom services research is now solidly in the able hands of Lara Warner and my terrific long-time teammates Julia Belladonna, Ido Cohen, and Connie Marotta…It has been a pleasure working with each of you over the past years. I have thoroughly enjoyed and benefited from every discussion and debate we have had. I hope you feel the same.”

Jack and I were twinned for so many years that I suppose it was fitting that just days after my Wall Street story ended, so, too, did his saga. On April 28th, 2003, Jack settled the SEC charges that had been levied against him without admitting or denying guilt. He agreed to pay a total of $15 million in fines. It was less than half of the severance package he’d collected upon “resigning” from Salomon Smith Barney. In effect, Citigroup shareholders had paid Grubman’s penalty and then some. For Jack, not a bad trade, as they say on the Street.

Though Jack also was censured and barred from working in the securities industry for the rest of his life, he ended up a winner by Wall Street’s rules of maximizing wealth. He netted approximately $17 million simply by getting fired. His massive legal bills would be paid by Citigroup, and nothing prevented him from setting up a consulting business or even becoming an executive of a publicly-traded company. Indeed, a recent press report says he is attempting to resurrect himself as a telecom consultant.[32] Because Spitzer opted not to pursue the Weill connection, we’ll never know for sure what happened on that end.

Jack has said many times, by way of defense, that he was a true believer in this new world, that he honestly did think that demand for bandwidth was infinite, and that it was this misguided belief—not his desire to maximize telecom banking fees or any pressure from the banking side—that led him to be so publicly bullish on stocks.

True? I don’t know. But I see things this way: Jack was so utterly certain that he had the inside track with so many telecom companies that it never occurred to him for a moment that what they told him might not be true. After all, if anyone would know what was going on, it was Jack. He thought he had a special, insider’s relationship with these executives, and many investors thought so too. But the special relationship Jack had with WorldCom is, of course, what ultimately undid him. Without the largest corporate fraud in history, Jack might

still be an analyst today, still playing the insider game to the tune of millions. It is just too ironic: the savviest, best-connected guy on the Street turned out to be, apparently, the unwitting dupe in one of the most audacious white-collar crimes ever.

Jack, the most accomplished player of the insider game, was ultimately destroyed by it. He thought he still had the edge—but that edge only mattered when the companies had the juice to pump their stock prices. As the telecom industry unraveled, Jack became just another analyst, a clueless conduit for the desperate mutterings of those who hoped to postpone the inevitable just a little bit longer.

He trusted his "friends." But with friends like Scott Sullivan and Bernie Ebbers, who needed enemies? In return for his fealty, they burned him. They burned everyone else, too, of course, but they really burned Jack. In the end, he was an outsider after all. The duper had been duped by criminals far more clever than he.

As I packed up my things, I contemplated what I had experienced in my time on Wall Street. I'd come in as an idealist and left a cynic. I was leaving almost exactly when I had planned. But that was probably the only thing that came out exactly as planned. Certainly, I had never imagined that the industry I covered would become so enormous and so central to the world. Nor could I have fathomed that it would collapse in a whirlwind of scandal, fraud, and overinflated expectations.

Overall, however, I had thoroughly enjoyed most of my time as an analyst. It was more intellectually stimulating and physically exhausting than any job I could have imagined back in my college days, or even in my early stints at MCI and Coopers & Lybrand. But I also had regrets about the job I had done and how I had handled some situations. For example, I should not have played banker, pitching my firms' investment banking services to Ameritech and AT&T, when the former was being acquired by SBC and the latter was preparing an IPO of its wireless unit.

Nor should I have had as much faith in the SEC as I did. Each time I heard allegations about leaks of inside information or about analysts twisting their stock ratings to serve bankers, not investors, I allowed myself to believe that the SEC (or some other regulatory agency) was already on the trail. Sure, I had heard the SEC was keeping tabs on analysts, even keeping a fat file on Grubman, and that Salomon's compliance department had investigated him. In retrospect, I should have taken it upon myself to report the leaks I heard about rather than

waiting for the regulatory agencies to figure out what was going on. I was far too willing to keep my head down, focusing narrowly on my research and ignoring what appeared to be going on around me.

Finally, my research certainly should have dug deeper into the numbers reported by such companies as WorldCom, Qwest, Global Crossing, and even IDB back in 1994. Catching understated expenses or overstated revenues is not easy. Nevertheless, I should have been more alert to the possibility of financial manipulation and to the corporate and accounting firm cultures that might foster it.

As I walked out of the doors at CSFB onto Madison Avenue for one last time, I shuddered to remember the distinction I'd made between the advertising firms of Madison Avenue, the "street where they fool people," and Wall Street. I had walked up Madison that summer day in 1989 with great disdain for the inherent fakery of the ad business, especially compared with the empiricism and objectivity of Wall Street research.

Ironically, several Wall Street firms, including CSFB, had since moved to Madison Avenue, where they apparently learned a lot from advertising firms. As I walked up that avenue for the last time as a Wall Street analyst, convincing people to buy a particular brand of soap suddenly seemed like a pretty harmless gig after all. At least it got you clean, and there isn't enough soap in the world to do that to Wall Street.

Epilogue:

Where Are They Now?

As of this writing….

Phil Anschutz—Anschutz remains chairman of the Anschutz Corp. In 2003, Anschutz settled a suit brought by Eliot Spitzer, alleging improper receipt of IPO shares from Salomon Smith Barney, by paying $4.4 million.[1] Since then, he has funded the Oscar winner *Ray,* owns *The San Francisco Examiner* and Los Angeles's Staples Center, and has stakes in the L.A. Lakers basketball team and the L.A. Kings hockey team. He still owns 18 percent of Qwest, worth about $1.1 billion, not counting the $1.9 billion in Qwest shares he had sold earlier. In contrast to Joe Nacchio, Anschutz was not charged in the March 2005 SEC complaint against five top Qwest executives. He is said to be worth about $5 billion.[2]

C. Michael Armstrong—The former AT&T CEO gambled and lost when it came to betting on cable as the future of AT&T. He retired in 2002 after he sold AT&T's cable operations to Comcast. Today, he remains on the boards of Citigroup, Hospital Corporation of America, and the Parsons Corporation. He's also taken to academia—he's a visiting professor at the Sloan School of Management at MIT, and he was recently named to a volunteer position at Johns Hopkins Medicine that oversees cooperation between the noted medical school and teaching hospitals in Baltimore. He has become a champion of stem cell research. He splits time between Darien, Connecticut, and Naples, Florida, with his wife, Anne.[3]

Jim Crowe—The former CEO of MFS has been CEO of Level 3

Communications since 1997.[4] He's still going strong, though Level 3's stock price has never recovered from its dot-com collapse.

Carol Cutler—Left the investment profession and is now working at Calvin Klein in Manhattan as a gift registry specialist.

Brady Dougan—When John Mack was ousted at CSFB in 2004, Dougan stepped in as the new CEO. Unlike Mack, however, he has not been made co-CEO of the parent company, Credit Suisse Group.[5] Trying to smooth over the rough edges, he keeps his tie tightened around his neck more often.

Bernie Ebbers—The former WorldCom chief, convicted of overseeing the company's $11 billion fraud, was sentenced to 25 years in prison on July 13,2005. If his appeal fails, he will likely spend his remaining days at the federal prison in Yazoo City, Mississippi, about 100 miles from his former home in Brookhaven, Mississippi. Since his sentence is more than 10 years, he did not qualify for placement at Yazoo's minimum security prison. He will likely be placed in a facility with about 1,750 other inmates. He'll sleep in a bunk bed with a roommate in a cubicle-like room. He'll also work seven hours a day, five days a week, as long as he's medically able, and will be given tasks ranging from food service and plumbing to painting and grounds-keeping. He might have a chance to ride a tractor, one of his passions.[6] Ebbers's wife, Kristie, will be allowed to visit for a minimum of four hours a month.[7]

Kristie, meanwhile, was allowed to keep a modest home in Brookhaven, $50,000 in cash, and a retirement account—livable, but a far cry from her days as the wife of a billionaire.[8]

Bill Esrey—The former Sprint CEO was forced out in 2003 after the IRS raised questions about some tax shelters he used when exercising a large number of stock options. If the IRS requires him to pay up, he could face substantial tax liability and penalties. Yet Esrey was given a severance package of over $10 million in addition to 10-year memberships in two country clubs as well as office space and secretarial help for the rest of his life.[9]

Ed Greenberg—Remains a successful senior telecom investment banker at Morgan Stanley.

Jack Grubman—Jack is still trying to hustle his vision of the telecom industry. A *Fortune* article described him meeting with small-time paging companies in order to impart his wisdom. While a defendant in numerous class-action lawsuits filed by disgruntled investors, he still maintains a six-story town house in Manhattan's Upper East Side that he once claimed would be featured in *House & Garden.* He also owns a home in East Hampton, Long Island. The twins graduated from the 92nd Street Y preschool and now attend public school right near the town house.[10] On January 24, 2003, a federal court consolidated approximately 80 actions against Salomon Smith Barney, Inc. and Jack Grubman, et al., involving allegations of securities fraud in connection with analyst research reports, into nine lead actions. At this writing, several cases are still pending before the Honorable Gerard E. Lynch, U.S. District Judge, Southern District of New York.

David Komansky—In the wake of the analyst scandals and subsequent settlements with Spitzer, Komansky pushed up his planned retirement date by a year, handing over the Merrill Lynch CEO post to Stanley O'Neal in late 2002 and the chairmanship in April 2003.

John Mack—After being forced out of CSFB in a power struggle with his Swiss bosses in 2004, "Mack the Knife" played some golf, briefly took on the role of "point man" in a dissident movement involving disgruntled seat holders on the New York Stock Exchange, and spent less than a month as chairman of a hedge fund. He triumphantly returned to Morgan Stanley on June 30, 2005, taking over from his nemesis, ousted chairman and CEO Phil Purcell, who had alienated the Morgan Stanley bankers.[11]

Joe Nacchio—Nacchio is the latest target of regulators, who filed a civil suit against him and six other former Qwest executives on March 15,

2005. The SEC accused Nacchio and the others of a "massive financial fraud."[12] He still lives in Mendham, New Jersey, with his wife, and resurfaced in 2004 as a consultant and even part-owner of BCN Telecom, a small-business telecom firm.[13] More than likely, his real job today is to prepare for the most important trial of his life, a trial that could take away from him much of the over $200 million he made by selling Qwest shares between 1999 and 2001. The U.S. Department of Justice has a criminal investigation underway of the fraud at Qwest, which raises the possibility of jail time if Nacchio is charged and convicted.[14]

Dick Notebaert—After Joe Nacchio was fired, Notebaert became chairman and CEO of Qwest on June 17, 2002, and remains there today. Qwest made an abortive bid for MCI in 2005.[15]

Frank Quattrone—After his first trial ended in a deadlocked jury, Quattrone was retried and convicted of three counts of obstruction of justice, on May 4, 2004.[16] He's likely sitting in his beautiful home overlooking the famed Pebble Beach golf course as he appeals the 18-month jail sentence. A federal appeals court heard arguments in the case July 12, 2005.[17] If his appeal fails, Frank will likely serve his sentence in a minimum-security, dormitory-style prison in California, much like Martha Stewart's famed "Camp Cupcake" in West Virginia.

Bert Roberts—The former chairman of WorldCom agreed on March 21, 2005, to pay $4.5 million to settle claims against him for his role in WorldCom's downfall. In an unprecedented move, Roberts and the rest of the board of directors paid a total of $24.75 million of their own money to settle a variety of lawsuits, with the board members' insurance policies kicking in another $36 million.[18] Usually insurance policies cover any corporate director's liability, but the lead in the class-action suits, New York State comptroller Alan Hevesi, wanted to make an example of WorldCom. The directors, according to Hevesi, each paid about 20 percent of their individual net worth.

Ivan Seidenberg—Ivan became sole CEO of Verizon in 2002 and was named chairman of the board in 2004.[19] In 2005, Verizon agreed to purchase MCI—the former WorldCom.

Eliot Spitzer—After years of unofficially running for governor of New York, Spitzer made it official in 2005, competing on his record of tackling corporate wrongdoing. Yet most of the cases he pursued were settled. Indeed, after settling with Grubman, he opted not to pursue Weill and other top Wall Street executives in the research scandals. Instead, he pursued high-profile cases against the mutual fund and insurance industries. His office's one Wall Street prosecution involved a mid-level Bank of America broker, Theodore C. Sihpol III, who was accused of late-trading in mutual funds on behalf of some hedge fund clients. Sihpol was acquitted of 29 counts at trial, including a top count of grand larceny, and the jury deadlocked on four others.[20] Shortly thereafter, Spitzer decided not to retry Sihpol on the remaining counts.

Scott Sullivan—On Aug. 11, 2005, in exchange for cooperating with the authorities in prosecuting Bernie Ebbers, Sullivan received a five-year federal prison sentence—a fifth of what he could have gotten—for his role in the WorldCom scandal.[21] His wife, who is diabetic, and his four-year-old daughter are still living in the same small ranch-style house in a modest neighborhood of Boca Raton, Florida, where they've lived since 1990. Sullivan will likely serve his sentence in a minimum-security federal prison in Pensacola, Florida, 600 miles from his home. In July 2005, Sullivan agreed to forfeit the multimillion-dollar palace he built but never managed to move into, along with his 401 (k) retirement fund, to settle a class action lawsuit.[22] The house sold in August 2005 for $9.7 million, less than half of its original price, while the 401 (k) is only worth $200,000 because most of it was tied up in now-worthless WorldCom stock.[23]

Robin Szeliga—The former Qwest chief financial officer pleaded guilty on July 14, 2005, to one charge of insider trading, and faces up to 10 years in prison and a $1 million fine. Yet the illegal transaction netted her just $125,000—not a good trade. She has also reached a deal with the SEC, and she is widely expected to testify against Joe Nacchio.[24]

Sol Trujillo—Even though Joe Nacchio edged him out after the Qwest-US West merger, Sol's career didn't grind to a halt. On July 1, 2005, he became the CEO of Telstra, Australia's national phone company, after spending two years as CEO of Orange, the huge

European wireless firm and subsidiary of France Telecom.[25]

Sanford I. "Sandy" Weill—Weill's reputation as the king of financial services took a hit after the Grubman scandal. At the end of 2003, he gave up his post as CEO of Citigroup, handing the day-to-day operations to Charles "Chuck" Prince.[26] Nevertheless, Weill remains chairman of Citigroup until April 2006, although in July 2005 he briefly considered stepping down early—on the condition that he continue to have use of the corporate jet and other lifelong perks.[27] Weill also remains heavily involved in charity work, perhaps securing a different kind of legacy by heading the Committee to Encourage Corporate Philanthropy and giving heavily to academic institutions and the arts. His name now graces Carnegie Hall's Weill Recital Hall, the Weill Music Institute, the Weill Cornell Medical College, and the Weill Cornell Graduate School of Medical Sciences.[28]

Ed Whitacre—Whitacre remains CEO of SBC Communications Inc.[29] In a stunning and ironic twist of fate, the former Baby Bell agreed to buy Ma Bell itself, AT&T, in 2005.

Gary Winnick—Despite founding Global Crossing and then selling more than $700 million in stock before it went belly-up, Winnick was never charged in the scandals surrounding the company and remains a multimillionaire, though his name hasn't graced the list of *Forbes*'s 400 richest Americans since 2003. Although no criminal charges were filed by the government, Winnick did face many civil suits. He paid $55 million to settle a class action lawsuit filed by shareholders.[30] Winnick continues to operate his investment firm, Pacific Capital Group, and he still maintains his 64-room mansion overlooking the Bel-Air Country Club, with renovations finally finished. Thanks to some big checks, his name can be found on the children's wing at the Los Angeles Zoo, a section of the L.A. Central Library, and a cafeteria at Long Island University, his alma mater.[31]

Afterword

Back to the Future: Some Policy Prescriptions

PLENTY OF LAWS, ethics policies, and regulations have been changed in hopes of cleaning up the Street. But will they make one whit of difference? Sadly, I think that few of them will have much impact in the long run. In part, that's because many create their own set of unintended consequences. I also think that the role of the analyst on Wall Street is filled with inherent conflicts, none of which can be solved by these rule changes.

I didn't realize this at first, however. Way back in 1989, when I started as an analyst at Morgan Stanley, I learned everything I needed to know about analyst independence, or so I thought, from Ed Greenberg. Ed was my mentor at Morgan Stanley, the consummate professional, and the guy who talked me into leaving MCI for the Street. His philosophy was simple, and I stuck with it for my entire career: think independently and don't let yourself be influenced by the "noise," as he called it. "Stay focused on analysis and valuation," he said. "The stock picking will flow from that."

It sounded pretty straightforward to me. But Ed warned that all the people around me, from the company executives to the traders, the bankers, and the buy-side clients, had different, and often competing, objectives. Paying too much attention to any of them would only distract me from my job, which was to figure out the future direction of the stocks on my coverage list. There was another reason for staying independent, and it was the most essential one. If I altered my opinions to serve some objective other than giving investors the best possible advice, it would mislead anyone who read my research and acted upon it.

If I ever needed a reality check, I got one every time I spoke to my parents, Muriel and Jack. They were on my mailing list and received all of my reports throughout the years. My father was in many ways a typical individual investor. He watched CNBC constantly and listened to the talking heads as if they were speaking the gospel. He also read virtually every single word I wrote and constantly talked to his friends about my stock picks. Every time I came down to Florida for a visit, I'd be mobbed by my mom's and dad's friends, living on their modest retirement incomes, who would ask me again and again what they should do with various stocks.

"You know, Danny, I own a lot of AT&T," a cheerful Aaron Beckwith would say, as I was still "Danny" with this crowd. "It's my largest stock position. What should I do with it?"

These were real people with real life-savings taking the advice of the supposed pros quite literally. In these cases, my recommendation might make the difference between a comfortable retirement and a miserable one. It was a very big deal. I eventually crystallized my feelings about Aaron and my parents into what I called the "grandma" approach to research: I should never recommend a stock that I wasn't comfortable recommending to my parents, my closest friends, or someone's grandmother.

That didn't mean that I shouldn't consider startups or risky stocks, but rather that I always had to do my homework, seriously investigate all the issues surrounding a stock, and do my best to come up with the right ratings, including the risk level. I wouldn't be right all the time, but I was obligated to do my best. Even though the clients I focused on were primarily large institutional investors, those institutions were often investing on the part of mutual and pension funds that perhaps managed my parents' or Aaron Beckwith's retirement savings.

Although the pressures from my larger, more powerful constituencies kept intensifying as the bull market picked up steam, I managed to stick to the Ed/Grandma approach pretty well over the course of my career. It was relatively easy at first, since very few people knew who I was and my calls didn't move stocks. Over time, as my work become more widely read, my rankings rose, and other analysts began to get cozier with the banking side of the business, it got increasingly more difficult, as I've described in this book.

But I had it easier than a lot of my counterparts. I was extremely lucky to have started on the Street at a time when there was very little investment banking activity in the telecom industry. The pressures

didn't really intensify until after I had built my reputation and had become ranked on the *Institutional Investor* magazine's All-America Research Team. And by then, my job—or at least the pay—was guaranteed under multiyear contracts. So by the time the bankers went into heat, I had financial security from the contracts and a decent amount of job mobility from the high *I.I.* rankings. That gave me the leverage to resist any pressure to write or say something I didn't believe.

DESPITE THE INHERENT conflicts of Wall Street, there are a few simple but strong actions that would go a long way toward deterring future misbehavior. Start with the vigorous enforcement of insider-trading laws and regulations. If analysts and others knew they'd go to jail when caught, the laws would deter over-the-Wall analysts from disclosing not-yet-public information. Vigorous enforcement would also deter corporate executives from using misleading or fraudulent accounting to give them time to sell shares when they are aware—but the public is not—that their company's fortunes are suffering. Aggressive enforcement actions could make a huge difference by deterring would-be criminals.

Second, I propose a new federal law requiring corporate insiders to pay back profits, if those profits have been earned by selling shares during a period of time when the company's stock price is artificially boosted by fraudulent financial disclosures. Those profits would then be refunded to investors in that company's stock.

Third, would be to lengthen "restricted" periods. Restricted periods are the period of time after a stock or bond offering or a merger or acquisition when analysts working for the involved banks have to be quiet. That means that they can't write research reports or give an investment opinion about those companies paying their banks an investment banking fee. Lengthened restricted periods would keep analysts silent and thereby reduce the likelihood that a banker or company would pressure or tempt an analyst to give a favorable rating to the stock of a company paying multimillion dollar fees to that analyst's firm.

Last and most important, investors need to be aware that they're playing a loser's game. No matter what laws or rules are changed, the investment banking and brokerage businesses are fraught with inherent and inevitable conflicts, conflicts that can hurt even the biggest investors. Rather than trusting in the inherent fairness of the

markets, individuals buying stocks should assume that they will never receive the same information as the professionals. It's an insider's world, and it always will be. Let me explain.

The Middleman's Dilemma

Real estate agents do it. Insurance brokers do it. Headhunters do it. And Wall Street brokerages and investment banks do it. They act as middlemen, trying to match buyers and sellers as often as possible and make as many deals as possible. And they all have inherent conflicts of interest that are simply part of the job. Does the real estate agent always point out the leaky roof to a buyer? Does the insurance broker always direct the customer to the best-priced insurance policy, even if his agency doesn't represent that company? Does the headhunter know or care whether the individual he has recommended will be a great performer or a Dilbert clone? The answer is no, and no one really expects them to do otherwise.

It's a similar situation on Wall Street. Securities firms or investment banks are the quintessential middlemen. They match buyers and sellers of securities, and their goal is to get the largest number of bonds, stocks, or some mix of the two bought or sold through their firm. This at first seems to create a built-in conflict, but the market's laws of supply and demand are supposed to neatly resolve this moral dilemma, since the price paid will be the price customers are willing to pay and sellers are willing to accept. However, if supply or demand is distorted by things like the unfair allocations of IPO shares or selectively disclosing nonpublic information, all of which you've read about in this book, it's a different story.

There is, however, something quite unusual about the securities industry: the role of the analyst. Research analysts are expected—and obligated—to pick a side in this conflict and to change sides whenever circumstances change. If an analyst recommends a stock, he is siding with the corporate issuer, suggesting that investors buy more of that stock and therefore allowing the corporate client to sell more shares at a higher price. But if an analyst advises investors to sell a particular stock, he is working against the corporate issuer because his advice could reduce demand for that stock, thereby lowering the price paid by investors and hurting the company's ability to raise money.

When I started on Wall Street, I naïvely assumed everyone I dealt with accepted the independence standard. I never really thought about where it came from, why people expected it, or why Wall Street

analysts were unique. Eventually, I started to see that the analyst's obligation to be independent, while ethically imperative, wasn't economically logical at all, given that he or she works for a firm whose primary purpose is to maximize fees. From the perspective of the cynic—or the economist—it makes sense that every employee of the firm, analyst or not, would work toward that goal.

In the 1990s, this "logical conclusion" became the norm for many analysts. Some of them changed their investment opinions to benefit companies that were paying fees that dwarfed any contribution that the other customers—the investors—were making. Ultimately, the banks and the analysts paid a price for this behavior, but that price was minuscule compared with the losses of the millions of people who trusted the advice they were given.

Can anything be done to restore the role of the analyst as an impartial adviser, or is it simply impossible given the inherent conflicts involved? And have the reforms put in place thus far done anything at all to bring the Ed/Grandma standard back to life? I will first address the simplest and most controversial proposal—the spinning off of research from investment banks altogether. Then I will critique the existing rule changes put in place by Eliot Spitzer and the National Association of Securities Dealers (NASD). Finally, I'll give my own prescription for the things I think we can—and should—change.

Why Spinning Off Research Won't Work

After discovering Henry Blodget's "POS" (piece of shit) e-mails, Eliot Spitzer opened his negotiations with Merrill Lynch by demanding that Merrill disband, sell, or spin off its research department, thereby eliminating any opportunity for conflicted research.[1] Though Merrill fought this aggressively and won, I imagine many Wall Street executives agreed with Spitzer. After all, research, once a valuable client service, seemed to have morphed into one huge conflict-of-interest machine with huge legal risks.

In my view, the proposal to spin off research makes no sense, because it's based on a misunderstanding of how securities are distributed in our markets. The problem is that if an investment bank or brokerage lacks research analysts, it will simply create them anew: inevitably, someone will emerge to describe and evaluate any stock or bond that the firm is selling. It might be a salesperson, broker, banker, or trader, but someone will end up explaining the stock to the firms' brokers, salespeople, and investor clients.

For example, say Verizon hires Citigroup to sell $1 billion of new stock. Someone has to explain Verizon's financials, strategic position, competitive position, and a variety of other factors to Citigroup's institutional salespeople and retail brokers. Normally, a research analyst would do so, as he or she would have the most knowledge of Verizon and the telecom industry. But with no research analysts, someone else would need to write up a "sales memo" and host a "teach-in" explaining the pros and cons of investing in Verizon. If a banker doesn't do it, someone in the equity syndicate department might. Or a salesperson may volunteer or be assigned to provide some "comps" tables, showing how Verizon at $35 a share compares to the valuations of other stocks and the market overall. That would leave us with a larger problem than we had before: an inexperienced salesperson with no pretense at all of being objective or independent serving as Citigroup's telecom "expert" even though he doesn't understand the business in any depth.

Some may argue it's better simply to call a spade a spade. Since it is sales on some level, why not call it sales and have it performed by a salesperson? Perhaps the fraud was in calling it independent research in the first place. I understand the argument, but in the end, jettisoning the research department simply shifts the burden of "explaining" a public offering to someone less qualified and possibly more conflicted.

The same principle holds if, instead of spinning off research, it is the banking side that is separated. Self-proclaimed "bankers" will emerge, and the same inherent conflicts of mixing banking and research will inevitably arise. The king is dead, long live the king.

A Critique of Actual and Proposed Reforms

In July 2002, roughly a year before Eliot Spitzer's $1.4 billion settlement with the largest investment banks was finalized in April 2003, the NASD, the industry group governing Wall Street firms, introduced new standards of conduct for research analysts, called Rule 2711.[2] The following section analyzes these reforms as well as some others.

1. Analyst Pay Can No Longer Be Tied to Specific Banking Deals

Firms can no longer pay analysts for specific investment banking deals they may have contributed to. Yet analysts can still be paid from

the general profits of the firm, including investment banking profits, as long as the bonuses are not tied to any specific deal. Bonuses are determined based on a variety of factors, ranging from stock-picking and buy-side surveys like *Institutional Investor* magazine's rankings to the quantity of reports, morning calls, and client contacts to feedback from colleagues.

But since many of these factors are subjective, there's still plenty of room for management to reward "banker-friendly" analysts with higher compensation. This means that the analyst can never really stay entirely free of banking as long as the investment banking department still pays many of the bills.

One possible alternative is that firms could pay research from the profits earned by the sales and trading departments, not by investment banking. Analysts could be still be evaluated based on a variety of quantifiable factors: stock performance, sales force feedback, survey rankings, quantities (of reports, morning calls, buy-side client meetings, and phone calls), trading volumes, and trading profits, although this, too, creates a conflict—who gets information from the analyst first, outside investors or internal traders? It might clean up the banking conflict, and analyst pay might fall significantly, but this arrangement might also increase pressures on analysts to put in-house trading interests ahead of those of outside investors.

2. Research Cannot Report to Anyone in Investment Banking

Merely redesigning the organization chart does not solve the conflict-of-interest problem, nor remove the temptation for investment banks to put the interests of its corporate clients above those of its investor clients.

Theoretically, research could report directly to the CEO, ostensibly insulating research analysts from business units within the firm. However, it is not practical for a CEO to directly supervise an entire research team given the demands on his time. Even if it were, such an arrangement would not eliminate the basic conflict of interest. The fact remains that the CEO's ultimate goal is to increase profits. Since investment banking generates profits and research doesn't, the CEO and other top executives still have a powerful incentive to reward employees who contribute to the firm's profitability or, at least, to look the other way when bankers are applying pressure on analysts.

This was not my personal experience, however. I worked and

traveled with five CEOs and presidents of Wall Street firms: Dan Tully, David Komansky, and Herb Allison at Merrill; Allen Wheat at CSFB; and John Mack at CSFB and Morgan Stanley. None of them ever asked me to alter my research opinions or tone, and none of them ever asked me to take a "fresh look" at any of the stocks I covered, as Sandy Weill admitted asking Jack Grubman to do on AT&T shares. But there is no doubt that each of them served as their firm's consummate banker and supersalesperson. In the end, not allowing research to report to banking prevents some overt conflicts, but it shouldn't be seen as a panacea.

3. "Independent" Research Mandated for Five Years

The Spitzer settlement requires each of the major Wall Street firms to offer its clients multiple research reports on each stock it covers, including reports written by "independent research" professionals, that is, firms with no involvement in investment banking activities.[3] Each bank is required to pay the independent firms from the $1.4 billion in fees paid in the settlement. So, for example, if you are a client of Merrill Lynch and you are thinking of investing in Google, upon your request your broker must now send you several reports on Google, one written by a Merrill equity analyst and the others by independent research firms hired by Merrill.

I think this "reform" should be ended as soon as possible. It is a waste of money, gives individual investors a false sense of trust, and it is rife with potential conflicts anyway. For starters, I'm not too sure what makes the researchers employed by the "independent" firms so independent. If their firms are competing for contracts with the top investment banks, wouldn't their analyst be tempted to be more bullish in order to help those banks build better relationships with their banking clients?

It's also a safe assumption that the pay for research analysts at these independent firms will be lower than at the big banks. So won't these "junior" analysts be out to impress the investment banks and then get hired by them? And, in order to counterbalance the bullish bias of the banks, the independent firms may end up with a negative bias. The final problem is that, of course, there is no guarantee that independent research will have much quality. Mostly younger and less experienced analysts will be hired. And since the settlement set a time limit of only five years for the independent-research requirement, the employees will have short-term mind-sets.

4. Analysts Can No Longer Participate in Road Shows or Beauty Contests

Analysts should be banned from attending "beauty contests," which are competitions where companies choose underwriters, but I think they should be allowed to attend "road shows," the traveling circus of presentations to large investors where managements pitch their stock.

In the past, analysts played a key role in explaining a new offering, such as an IPO, to investors. They often accompanied the company's management on the "road show." Under pressure from Eliot Spitzer and the SEC, the NASD concluded that analyst participation in road shows can heighten pressure on the analyst to be bullish on that stock in exchange for the banking business. The NASD's solution was to ban analysts' participation in and attendance at road shows.

I think the decision is absurd. I don't see how accompanying management to meetings with big investors makes the conflict question any more or less problematic. The rule does, however, constrain an analyst's ability to understand the company and do good research. I attended road-show presentations because I wanted to hear what kinds of questions potential investors were asking and I wanted to hear how management answered those questions. Getting this perspective helped me do my job, which was to know this company, its management, its financials, and its strategy inside and out. What is even more absurd is that under the new rule, analysts from other banks are allowed to attend some of the meetings but an analyst whose firm is managing the offering cannot. If an analyst ends up less informed than he or she otherwise would be, it's a disservice to all investors.

Now let's look at beauty contests, which are the inverse of road shows. Here, a bank, not a company, showcases its services in the hope of winning the right to handle a company's upcoming stock or bond offering. Typically, company management sits on one side of a table while groups of bankers and analysts traipse in, one after another, spreadsheets at the ready, hoping to convince the company that their firm should handle the deal. In my view, banning analysts from attending beauty contests does little to eliminate or even reduce conflicts. If an investment banker wants to pressure an analyst for positive coverage of a company *and* if the analyst is willing to bend to that pressure, skipping a beauty contest won't make much difference.

That said, unlike at the road show, the analyst doesn't learn much about the company at beauty contests that would improve his research. For that reason, I don't have a problem with prohibiting analyst attendance at these meetings.

5. Analysts Should Not Attend Board Meetings

This is not a formal rule, but it is becoming the de facto way of doing business on Wall Street. I think it is silly. A really good analyst is an expert in his or her industry, which means that members of boards of directors, who often are *not* industry experts, could benefit from his or her insights. If a board wants to hear those insights, why can't an analyst make a presentation?

The key is to keep analysts and all outsiders away from observing actual board deliberations. That is what creates the potential for analysts revealing inside information.

6. Each Analyst Must Have a Certain Percentage of Sell Recommendations in His Portfolio

This is not officially part of the NASD's new rules. However, some investment banks have set sell quotas for their analysts, such as my former firm, CSFB, which requires each of its analysts to rate at least 15 percent of his or her coverage list "Underperform" or "Sell." This is true even if the analyst thinks that investors should be overweighted in his sector versus the broader market indices.

The problem with this rule is that mandating sell recommendations only leads to bad stock picking. It is true that sell recommendations were as rare as a blue-footed booby during the 1990s and that the inflation of investment recommendation ratings—in effect, grade inflation—was truly out of control.

The problem here is that this is one of those rules that sounds great but is far too easily circumvented. I, for one, never wasted time writing reports on companies or stocks that looked like bad investments. My job was to find good investments for my clients, which naturally skewed my attention toward companies with better-than-average prospects and, therefore, my ratings to the positive side. With quotas for Sell-or Underperform-rated stocks, analysts will simply add a few bad companies to their coverage lists to meet the

quota. It does not necessarily mean that stocks of banking clients will now be rated Sell, nor does it mean the analyst will be free from conflicts or pressures to be bullish.

Moreover, what many people have forgotten is that a Sell recommendation can sometimes be very bad advice. In the 1990s, most Sell ratings would have been the wrong ratings because the bull market, as it turned out, was an extremely powerful one that took on a life of its own.

7. Analysts Must Certify That Their Opinions Are Their Own

As of April 14, 2003, analysts must sign a form attesting that they believe what they have written in a given report.[4] This might be helpful in the sense that it reminds analysts every time they write a report that they are expected to be independent of the bankers and to publish honest research. But in my view, analyst certification does nothing more than that.

The reality is that liars will be liars, whether they sign a certification form or not. Does anyone really believe that someone who was willing to recommend a stock for reasons other than the merits of the stock would hesitate to lie on the analyst certification form? The same can be said about the Sarbanes-Oxley requirement that CEOs and CFOs of publicly-traded companies must certify in writing the accuracy of the company's accounting and financial statements. Would WorldCom's Scott Sullivan or Enron's Andrew Fastow have been honest CFOs if they were required to certify their company's financial statements? Dishonest analysts will have no trouble signing their names to anything. Honest analysts are already publishing honest research. That said, requiring certification doesn't have a downside, as long as investors don't allow themselves a false sense of comfort.

What Needs to Be Done

1. Stop Making Crime Pay: Vigorously Prosecute Insider Trading

Investment banks are sieves when it comes to insider information. Sometimes it is as simple as a driver or corporate security guard overhearing a conversation or noticing that some high-level executives

from another company have come in for a sudden visit. Sometimes, it happens when analysts go over the Wall and are tempted to share some of what they've learned so that they seem better-connected in their industry. It's a self-reinforcing, vicious cycle: the more "in the flow" an analyst is perceived to be, the more influential he or she will be, because investors will be more willing to follow his or her advice. The more influential he or she is, the more corporate executives will seek out his or her research support, which of course leads to pressure on the analyst to write positive research. As a result, that analyst can bring in bigger and bigger banking fees.

The only way to put an end to the cycle is to make it clear that insider trading in any form, including knowingly trafficking in inside information, will get you substantial time in the clink. Anyone who acts illegally as a tipper or tippee, including lawyers, secretaries, drivers, delivery services, printers, bankers, or analysts, should be harshly prosecuted with much longer sentences than currently exist. That would have tremendous deterrent impact. As we've seen, the enforcement of insider-trading laws has been spotty at best. The spread of inside information is much more pervasive than people know, and it will continue to flourish until the law is vigorously enforced by securities regulators and government prosecutors.

Wall Street is an extraordinarily tempting place. Money is everywhere, in huge, unfathomable quantities. Everything there—one's stature, one's self-esteem, one's past, one's future—is defined in terms of money. In view of this, shouldn't we offset those temptations with more vigorous enforcement of insider-trading laws?

2. Force Insiders to Repay Fraud-Inflated Stock Profits

Second, I propose a new federal law that requires corporate insiders to repay profits obtained by selling shares that have been artificially boosted by fraudulent financial disclosures. I first became aware of this idea when I stumbled upon a blogger named Mark Pincus.[5]

His idea is essentially that any insider who sells stock during a time of accounting fraud (and subsequent restatement) must return his or her profits to the extent they are attributable to the fraud, regardless of whether the insider knew about the fraud.

Of course, some constraints would be necessary. For example, "insider" would have to be clearly and quite narrowly defined;

government attorneys and private plaintiffs would have to convincingly quantify the degree to which the relevant stock price was inflated; and a statute of limitations must apply.

A law like this could have a profound deterrent effect on corporate accounting fraud. Corporate executives who might not investigate wrongdoing or who might ignore it altogether might, instead, dig deeper to make sure the company's financial reporting and accounting are legitimate.

Government attorneys and private plaintiffs would have to overcome two hurdles. First, they would have to prove the seller fit the definition of an "insider." Perhaps the law could define an insider as the top 50 executives of a publicly traded company, plus members of its board of directors. Second, they would have to establish the amount by which the security's price was fraudulently boosted. That would involve subjective estimates and valuation work, but juries and judges often make judgments of this sort when awarding damages and imposing penalties. In contrast to current laws, government attorneys and private plaintiffs would not need to prove the insider had knowledge of the fraud or used material, nonpublic information in the decision to sell.

3. End Analysts' Wall Crossings

In the end, going over the Wall is just not worth the hazards. It has become an experience that offers more risks than rewards. The potential for disclosure of nonpublic inside information is simply too great. The Chinese Wall should be rebuilt to what it was supposed to be in the first place—an impenetrable barrier that protects the private information of an investment bank's corporate clients and keeps that information from falling into inappropriate hands, including those of stock and bond research analysts.

4. Extend the Post-Issuance "Restricted Periods" During Which Analysts Cannot Publish

In 2002, the NASD extended what it calls its "restricted period" for IPOs from 30 to 40 days and left the one for secondary offerings unchanged, at 10 days. A restricted period is the amount of time a securities firm and its analysts must wait after an investment banking

client issues securities before discussing or publishing a research report on that company. Although the extension was the right idea, these periods are still not anywhere near long enough to reduce the pressures discussed in this book.

We need much longer restricted periods to disconnect corporate executives from the idea that their investment bank should provide supportive research. If the restricted period were as long as a year, companies would then hire bankers with the full understanding that the investment bank's researcher will be silent for a very long time.

There should also be a long restricted period for M&A transactions, say six months from the time a deal closes, in addition to the many months between the deal's announcement and its approval by regulators and shareholders. At best, this would encourage corporate executives to hire investment banks for their excellent advice and execution, not for favorable research. At worst, it would encourage companies to hire investment banks that do not have well-followed research analysts, flipping the influential research analyst from an asset who might attract banking business to a liability. What better way to sever these financial ties than to turn temptation upside down?

It is true that this may hurt small investors, especially individuals who have only one brokerage account and thus only one source of research. A year or more is a long time for investors to wait for research reports from the underwriter. Nevertheless, the tradeoff is a positive one.

5. Prohibit Analyst Commentary on M&A Banking No More SEC No-Action Letters

Talk about unintended consequences. The SEC's 1997 No-Action Letter—the one I discussed in detail in chapter 6 that allows analysts to write about mergers even when a deal is still pending and when their own banks are involved—did as much to corrupt Wall Street research as any of the crooks did themselves. This rule actually put the analyst in an often explicitly conflicted position. It was inadvertent; the intent was to help out individual investors who might not have access to more than one firm's research as a deal was unfolding.

But that's not what happened. Arthur Levitt, who was chairman of the SEC in 1997 when the letter was issued, may have given lots of speeches castigating analyst conflicts of interest. But with this letter,

his agency also unleashed one of the most pernicious conflicts in the history of the analyst profession. Before the No-Action Letter, analysts whose firms were advising a company involved in a merger were prohibited from commenting on the deal or on its implications for the two stocks involved in the transaction. So a firm with an influential, well-respected, *and* bullish analyst sometimes lost a deal because the corporations involved knew the analyst couldn't publish any reports while the deal was in process. Companies did not want to lose that analyst's positive influence in the marketplace.

The SEC's move turned that upside down. The regulators apparently forgot that most M&A fees aren't paid to bankers until and unless the deal closes. So once analysts were cleared to write about pending deals, fee-hungry bankers had every incentive to push them to write positive reports. It wasn't long before some corporate executives demanded positive research coverage as a quid pro quo for hiring investment banks as advisers on M&A deals. That, in turn, meant it now made sense for corporations, in search of supportive research commentary and higher stock prices, to hire firms with bullish or pliable analysts, fostering blatant conflicts of interest.

As suggested in point four, analysts working for banks handling mergers or acquisitions should be totally restricted from commenting on the involved companies for a long period of time, say until six months beyond the day the deal closes. That means no reports, no target prices, no investment rating, not even bare-bones, factual "outlines of the deal" reports, and no talking to clients about it. The only acceptable research, in my view, would be reports analyzing a deal's implications for other companies in the industry, provided the implications for the two companies involved in the deal are not discussed in the report.

The implications of this reversal could be radical. Muzzling the analyst would, in my view, turn the incentive and conflict structures on their heads, just as longer restricted periods would. At best, corporate executives might hire investment banks for their excellent advisory and underwriting skills, not for favorable opinions from influential research analysts. And, at worst, companies might intentionally hire bankers whose research analyst is bearish in order to silence that analyst and, conversely, avoid hiring investment banks whose analyst is bullish in order to keep that bullish voice alive.

Under these rules, investment banks would have to completely reevaluate whether they wanted to pay top dollar for highly influential analysts, since research could become not just a cost center

but also a repellent for investment banking fees. That's because the more bullish and influential a firm's researchers, the fewer deals and thus fewer banking fees might be collected. Analyst pay would go way down, as it would no longer be subsidized by the investment banking department. While this raises the risk of lessening the quality and frequency of research, it could significantly reduce the financial incentives that led to much of the dishonest and fraudulent research in the 1990s.

6. Make the Boss Accountable

Although he later pushed all the way to the top of the organization in companies like AIG, Eliot Spitzer, for some reason, ended his investigations of Wall Street firms before finding out whether the top executives of investment banks were involved in encouraging tainted research, IPO spinning, and other misdeeds. I think it was an enormous missed opportunity to change the culture of the Street and deter more bad behavior. Employees (in this case, analysts) often follow the cues and encouragements of their bosses. So, if only the analyst is pursued, the bosses may continue to condone or encourage bad or fraudulent behavior.

7. Tell Individual Investors the Painful Truth

Individuals should *not* be buying individual stocks. I know this is a radical statement, especially coming from a guy who researched individual stocks for a living. But there are simply too many insiders with too many unfair advantages. Biased research or not, insider trading or not, the markets are, and will remain, rampant with uneven information flow. Some privileged or talented professionals will always receive or ferret out information earlier than everyone else. To be an investor in this environment is like being a drug-free athlete whose competitors are all juiced up on steroids.

As you've read, analysts were subject to numerous and intense pressures—pressures from bankers, retail brokers, institutional money managers, buy-side analysts, hedge funds, in-house traders, even the press. Most of these people wanted bullish calls on particular stocks. Some wanted bullish calls on every stock. Some firms—usually hedge funds—pushed for bearish calls on particular stocks they had sold short. Traders often simply wanted more trade-inducing action—more research reports, more presentations to the morning meeting, more

break-in calls on the squawk box, and, if possible, louder and more extreme, or "marketable," calls. The individual investor has no clue about all of these crosscurrents. But professional investors often use these conflicting agendas as part of their investment strategy.

Stronger enforcement of insider-trading rules can help to reduce some but not all of this unevenness. Nevertheless, individual investors should assume that the information and advice they receive regarding individual stocks are stale and, to a large degree, already incorporated into stock prices. Even the majority of professional investors find the deck is stacked against them, since it is only a minority of well-connected, high-commission-paying, deal-absorbing institutions that receive the favored information flow.

In my opinion, it's better to buy stock indexes or broad-based mutual funds where the edge one professional fund manager may have in one stock may be offset by the advantage another fund manager has on a second stock. Hopefully, one of those groups is managing your money. But if individual investors do buy individual stocks and bonds, the rule should be *caveat emptor:* investors need to be reminded that the various strands of advice they are receiving come from people who have their own, potentially conflicted, agendas. That could be anyone from television commentators to journalists, analysts, bankers, or other groups.

In some cases, these advisers have their own investments and are trying to condition the market to support their position; in other cases, "experts" may be paid by the companies they tout. Of course, there are independent voices, but the point is that it's impossible to know who really is and who really isn't independent.

Of all the lessons I've learned in my time on the Street, the most difficult one to swallow is that I no longer believe in the transparency of the American financial system. When I came to the Street, I saw it as a place where there were plenty of sharks, but also as a place where American capitalism reigned supreme, a place where everyone had a chance to do well if they were smart, hardworking, and a little bit lucky. It was a game I enjoyed playing—at least until I realized how corrupted the game had become.

But I also came to realize that for people who don't have access to this inner sanctum, Wall Street is not a game at all. It's deadly serious, and it's rigged against most of its participants—everyone but the few with a seat at Wall Street's special tables. If you take anything away from this book, I hope it is this unfortunate truth.

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Glossary

arbitrage, general—The practice of buying securities in one market and shorting (selling) them in another, with the goal of capturing as profit any price discrepancies between the two markets.

arbitrage, merger—The practice of seeking to make a profit on the difference between the stock prices of companies involved in a merger. In most cases, arbs bet that the merger will be completed within a certain time frame and that the acquiree's (target's) stock price will eventually rise to the offered takeout price as the deal nears completion. To counter other risks not specific to the probability of the acquisition being completed, arbs usually sell short the acquiror's shares (see definition of *short*).

arb spread—The difference between the price offered for a company and where it's currently trading.

Baby Bells—Seven local telephone monopolies established in 1983 when AT&T ("Ma Bell") was broken up into a long distance company (AT&T) and seven "Baby Bells": Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell Telephone Company (later renamed SBC), and US West. Subsequently, SBC acquired Pacific Telesis (1996–7) and Ameritech (1998–9); Bell Atlantic acquired NYNEX (1996–7) and non–Baby Bell GTE (1998–9), forming Verizon; and US West merged with Qwest (1999–2000).

brokerage firm—Wall Street firm providing trading and investment advisory services to individual and/or institutional investors. Known as the *sell-side.* Commissions paid by investors comprise the bulk of revenues. Note: the vast majority of Wall Street firms provide both brokerage and investment banking services under one roof. See the definition of *investment bank.*

buy-side analyst—Analyst employed by institutional money management firms; provides in-house investment analysis and advice to that firm's money managers.

EBITDA—Earnings before interest, taxes, depreciation, and amortization. An alternate measure of corporate profitability often used in the nineties for startup companies with little or negative earnings per share. Sometimes also referred to as operating cash flow.

EPS—Earnings per share. The most commonly used measure of a company's current profitability.

emerging broadband telecom companies—Startup companies focused on building high-speed, broadband-ready (i.e., Internet-ready) intercity and international fiber-optic networks. Included Qwest, Global Crossing, and many others, most of which eventually went bankrupt.

I.I.—*Institutional Investor* magazine. **incumbent long-distance companies**—AT&T, MCI, Sprint, and LDDS (subsequently renamed WorldCom and MCI WorldCom).

insider tipping—Occurs when an insider ("tipper") deliberately passes on information that he knows is material and nonpublic to an outsider ("tippee"), in violation of a fiduciary duty to the issuer, where the insider's intent is to give that tippee a trading advantage in the stock market.

insider tippee—The person receiving insider information. Tippee liability requires that the recipient knew or should have known that there has been a breach of fiduciary duty by the source of the information.

insider tipper—The person passing on inside information. **insider trading**—The act of buying or selling a security while knowingly having material, nonpublic information about the security, in breach of a fiduciary duty or other relationship of trust and confidence.

institutional salesperson—Individual employed by a brokerage firm who is responsible for serving institutional money managers. He or she provides investment advice, passing along investment ideas from the firm's research analysts and trading ideas from its trading desk, and tailoring that advice to the unique needs and investment style of each institution.

institutional investor—Portfolio manager or analyst working at a

professional money management firm. These firms include mutual funds, pension funds, hedge funds, and arbitrage firms. Also known as a buy-sider.

investment bank—Wall Street firm providing advice to corporations and governments with regard to raising funds (selling stocks, bonds, and other securities) and with regard to mergers and acquisitions. Fees paid by corporations and governments comprise the bulk of revenues. Note: most investment banks also have brokerage divisions and thus provide advice to both issuers (corporations and governments) and investors, generating potential conflicts of interest.

IPO—Initial public offering. The process by which a privately owned company issues shares to the public for the first time.

IPO spinning—The act of an investment bank allocating shares in hot IPOs to corporate executives, presumably in hopes of receiving investment banking business from those corporations.

NASD—National Association of Securities Dealers.

P/E ratio—A stock's price (per share) divided by its annual earnings per share. The most commonly used valuation measure for publicly traded stocks, though the EBITDA multiple was commonly used in the late nineties, especially for startups.

ratings categories (for sell-side research opinions and recommendations):

rating 1: Often labeled Strong Buy or Buy. Top rating used by sell-side analysts. Most commonly defined as a stock for which the analyst foresees 20 percent or more upside over the next year.

rating 2: Often labeled Accumulate or Outperform, or sometimes Buy. Most commonly defined as a stock with 10–20 percent upside over next year.

rating 3: Commonly labeled Hold or Neutral. Most commonly defined as a stock expected to trade up or down 0–10 percent over the next year. Often perceived by institutional investors as an unattractive stock.

rating 4: Commonly labeled Underperform or Reduce. Analyst expects 10–20 percent downside over the next year. Second-lowest rating. Rarely used by Wall Street analysts in the late nineties.

rating 5: Commonly labeled Avoid or Sell. Analyst expects 20 percent or more downside over the next year. Lowest rating. Extremely rarely used in late nineties.

retail broker—Individual employed by a brokerage firm (such as Merrill Lynch or Smith Barney) responsible for advising individual ("retail") investors. Also known as a financial consultant or financial adviser.

retail investor—Individual investing his or her own money, sometimes with the advice and assistance of a full-service retail broker (financial consultant) such as Merrill Lynch or Smith Barney, and sometimes via discount and/or online brokers such as Schwab or Ameritrade.

sell-side analyst—Analyst employed by an investment bank and/or brokerage firm; provides investment analysis and advice to that firm's institutional and/or retail investor clients. The analyst's research is often published, widely distributed, and sometimes widely quoted.

short—As in "shorting shares of x company." The practice, used especially by arbitrageurs and hedge funds, of borrowing someone else's stock and selling it with the commitment to buy it back later at the future market price. The shortseller's bet is that the stock will fall and then he or she can buy back the shares at a lower price, pocketing the difference.

startup local phone companies—Companies that attempted to compete with the Baby Bells by building local phone systems and/or renting parts of the Bell networks. They included companies such as Metropolitan Fiber Systems (MFS), which was acquired by WorldCom in 1996; Teleport, acquired by AT&T in 1998; and a long list of companies that eventually went bankrupt including ICG, Intermedia, Focal, McLeodUSA, Metromedia Fiber Network, and Winstar. Also known as competitive local exchange companies (CLECs), though we avoid use of that acronym in this book.

swaps—In the telecom industry, the exchange of communications capacity between two companies with one company "purchasing" capacity from a second company as long the second agrees to purchase capacity from the first. If not disclosed to investors, they are very misleading as they suggest that revenues are higher and growing faster than they really are.

venture capitalist (VC)—Investor who specializes in investing in

startups and other not-yet-public businesses with exceptional growth potential.

Searchable Terms

Abbott, Ray
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